Ontario Energy Board

Ontario

REFERENCE FROM THE
LIEUTENANT GOVERNOR
IN COUNCIL

Gas Supply

E.B.R.L.G. 32

REPORT OF THE BOARD

E.B.R.L.G. 32

THE ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act, R.S.O. 1980, Chapter 332, as amended, and particularly Section 36 thereof;

AND IN THE MATTER OF a reference from the Lieutenant Governor in Council with respect to all matters pertaining to the supply of natural gas to meet the current and future needs of gas users in Ontario.

BEFORE:
J.C. Butler
Vice-Chairman and
Presiding Member

O.J. Cook
Member

C.A. Wolf Jr.
Member

REPORT OF THE BOARD

ISBN 0-7729-4812-7

October 14, 1988

Ontario

Ontario
Energy
Board

Commission
de l'Énergie
de l'Ontario

P.O. Box 2319
2300 Yonge Street
26th Floor
Toronto, Ontario
M4P 1E4
416 481-1967

C.P. 2319
2300, rue Yonge
26e étage
Toronto (Ontario)
M4P 1E4
416/481-1967

October 14, 1988

To His Honour the Lieutenant Governor in Council

By Order in Council O.C. 1290/88 dated May 19, 1988, the Ontario Energy Board was directed to hold a public hearing and to report on matters pertaining to the current and future supplies of natural gas required to meet the needs of Ontario gas consumers.

The Board herewith submits its final report in this matter.

Respectfully submitted,

ONTARIO ENERGY BOARD

J.C. Butler
Vice-Chairman and
Presiding Member

O.J. Cook
Member

C.A. Wolf Jr.
Member

TABLE OF CONTENTS

		PAGE
1.	**INTRODUCTION**	1
	The Reference	1
	The Hearing	2
	Appearances	3
	Witnesses	6
	Interim Report	9
	Miscellaneous	10
2.	**PRINCIPLES OF SECURITY OF SUPPLY**	11
	Introduction	11
	Board Conclusions	11
3.	**SHORT-TERM SUPPLY ARRANGEMENTS**	13
	Introduction	13
	Minimizing Risk	14
	Diversity	14
	Backstopping	14
	Board Conclusions	15
	Board Recommendations	17
	Other Concerns	18
	Board Conclusions	18
	Board Recommendations	19
4.	**LONG-TERM SUPPLY ARRANGEMENTS**	21
	Introduction	21
	Continental Market/Free Trade	22
	Board Conclusions	23
	Long-Term Contracts in Other Market Areas	24
	Board Conclusions	25
	Supply/Demand Balance and Impact On Uncontracted Reserves	27
	Board Conclusions	29
	Board Recommendations	32

PAGE

5. **TRANSPORTATION CAPACITY** 34
  Introduction 34
    Board Conclusions 36
    Board Recommendations 43

6. **MARKET SEGMENTATION** 47
  Need for Segmentation 47
  Introduction 47
    Board Conclusions 48
    Board Recommendation 51

7. **SECURITY OF SUPPLY MEASURES** 52
  Introduction 52
    Board Conclusions 52
    Board Recommendations 55
  Contract Terms and Conditions 55
  Introduction 55
    Board Conclusions 55
    Board Recommendations 56
  Market Access and Obligation to Supply 56
  Introduction 56
    Board Conclusions 57
    Board Recommendation 58

8. **MARKET IMPACT FROM SECURITY OF SUPPLY MEASURES** 59
  Relative Price Among Groups 59
  Introduction 59
    Board Conclusions 59
    Board Recommendations 61
  Competition Among Suppliers and Market Access 62
  Introduction 62
    Board Conclusions 62

PAGE

9. **ARBITRATION PROVISIONS** 63

Introduction 63
- Board Conclusions 64
- Board Recommendations 66

10. **POSITIONS OF THE PARTIES** 67

Principles of Security of Supply 67
- The LDCs 67
- The Brokers 69
- The Producer Associations 70
- Consumers and Consumer Associations 71
- WGML 72
- The Director 72
- Lambton 72
- Board Staff 73

Short-Term Supply Arrangements 73

Diversity 73
- The LDCs 73
- The Brokers 74
- The Producer Associations 75
- OAPPPA 75
- WGML 75
- Board Staff 76

Backstopping 76
- The LDCs 76
- The Brokers 77
- The Producer Associations 78
- Consumers and Consumer Associations 78
- Lambton 79
- Board Staff 79

Other Concerns 79
- The LDCs 79
- Pan-Alberta 80
- CPA 80
- IGUA 81
- WGML 81
- Board Staff 81

PAGE

Long-Term Supply Arrangements 82
Continental Market/Free Trade 82
    The LDCs 82
    The Brokers 83
    The Producer Associations 85
    OAPPPA 86
    WGML 86
    The Director 87
    Board Staff 89
Long-Term Contracts in Other Market Areas 89
    The LDCs 89
    The Brokers 90
    The Producer Associations 91
    WGML 92
    The Director 92
    Board Staff 93
Supply/Demand Balance and Impact on Uncontracted Reserves 94
    The LDCs 94
    The Brokers 95
    The Producer Associations 97
    The Consumer Associations 97
    WGML 98
    The Director 99
    Board Staff 101
Transportation Capacity 102
    The LDCs 102
    The Brokers 105
    The Producer Associations 108
    Consumers and Consumer Associations 110
    WGML 111
    The Director 111
    Board Staff 112
Market Segmentation 113
    The LDCs 113
    The Brokers 115
    The Producer Associations 116
    Consumers and Consumer Associations 117
    WGML 118
    The Director 119
    Board Staff 120

PAGE

Security of Supply Measures 121
Short-Term Supply Security 121
    The LDCs 121
    The Brokers 122
    The Producer Associations 123
    OAPPPA 124
    WGML 124
    The Director 125
    Board Staff 125
Contract Terms and Conditions 126
    The LDCs 126
    The Brokers 127
    The Producer Associations 128
    Consumers and Consumer Associations 128
    WGML 129
    The Director 129
    Board Staff 130
Market Access and Obligation to Supply 130
    The LDCs 130
    The Brokers 131
    IPAC 132
    Consumers and Consumer Associations 132
    The Director 133
    Board Staff 134
Market Impact From Security of Supply Measures 134
Relative Price Among Groups 134
    The LDCs 134
    The Brokers 136
    The Producer Associations 136
    The Consumer Associations 137
    WGML 137
    Board Staff 137
Competition Among Suppliers and Market Access 138
    The LDCs 138
    The Brokers 139
    The Producer Associations 139
    The Consumer Associations 140

PAGE

  - WGML 141
  - The Director 141
  - Board Staff 141
- Arbitration Provisions 141
  - The LDCs 141
  - The Brokers 146
  - The Producer Associations 149
  - The Consumer Associations 152
  - WGML 153
  - The Director 154
  - Board Staff 155
- Implementation 155
  - The LDCs 155
  - The Brokers 157
  - The Producer Associations 157
  - The Consumer Associations 158
  - WGML 158
  - The Director 159
  - Board Staff 159

1. INTRODUCTION

The Reference

1.1 By Order in Council O.C. 1290/88 dated May 19, 1988, the Lieutenant Governor in Council (the LGIC), pursuant to Section 36 of the Ontario Energy Board Act (the Act), directed the Ontario Energy Board (the Board or the OEB) to report on matters pertaining to the supply of natural gas to meet the current and future needs of gas users in Ontario. The Order in Council directed that the matters to be examined encompass, but not be limited to:

1. the short, medium and long-term implications for supply arrangements of: deliverability, price determination, gas reserves and all transportation arrangements; and

2. the extent to, the mechanisms by and the conditions under which the costs of security of gas supply procured by local distribution companies (LDCs) should be borne by users who cease purchasing, who choose to retain the right to purchase or who commence purchasing gas from their LDCs.

The Hearing

1.2 By Procedural Order - 1, dated May 25, 1988, the Board called a hearing and ordered that all intervenors who wished to present evidence prefile their written evidence with the Board by June 23, 1988. Sixteen intervenors submitted prefiled evidence.

1.3 The Board set out, in Appendix B to the above Order, a list of matters to be addressed during the hearing. These were:

1. Supply Components
2. Supply Failure
3. Market Development
4. Relative Risk
5. Risk Impact of Affiliate Relationships with Producers
6. Producer Risk and Behaviour
7. Customer Risk and Behaviour

8. Supply/Demand Balance
9. Contracting to Minimize Risk
10. Cost of Security
11. Cost of Supply Failure
12. Recontracting
13. Security of Supply and the Marketplace
14. Legal Matters
15. Other Matters.

1.4 A Procedural Day was held on June 27, 1988. The hearing of evidence began on July 5, 1988, and concluded on July 21, 1988. Final arguments were filed by twenty intervenors and Board Staff on or about July 29, 1988.

1.5 A verbatim transcript of the proceedings, together with a copy of all exhibits, is retained in the Board's files at 2300 Yonge Street, 26th Floor, Toronto, Ontario. These documents are available for public examination during regular business hours.

Appearances

1.6 The following are the intervenors and their counsel or representatives who appeared or participated actively in the proceedings:

Board Staff	J. Campion
The Consumers' Gas Company Ltd. (Consumers')	P. Atkinson

Union Gas Limited (Union)	G. Leslie
ICG Utilities (Ontario) Ltd (ICG)	J. Roland A. Dadson
Western Gas Marketing Limited (WGML)	R. Young
Association of Municipalities of Ontario (AMO)	J. T. Brett
GasPurchase Direct Limited (GasPurchase)	J.T. Brett
Ocelot Industries Ltd. (Ocelot)	J.T. Brett
Canadian Petroleum Association (CPA)	D. Holgate
Industrial Gas Users Association (IGUA)	P. Thompson
Independent Petroleum Association of Canada (IPAC)	J. Snider
Ontario Association of Physical Plant and Planning Administrators (OAPPPA)	J. Jolley
Eastern Canada Natural Gas Brokers Inc. (ECNG)	W. Houston
North Canadian Oils Limited/North Canadian Marketing Inc. (NCM)	M. Hopkins
Saskatchewan Oil and Gas Corporation (Sask Oil)	M. Hopkins
Northridge Petroleum Marketing, Inc. (Northridge)	P. Budd

PSR Gas Ventures Inc. (PSR)	P. Leier
Pan-Alberta Gas Ltd. (Pan-Alberta)	L. Meyer F. Foran
C-I-L Inc. (CIL)	P. Jackson A. Alexandrof
The Director of Investigation and Research, Competition Act (the Director)	N. Schultz D. Trinear
Lambton Gas Storage Association (Lambton)	A. Kimpe
Maple Leaf Mills Limited (Maple Leaf Mills),	E. McDougall
Cargill Grain Company Limited (Cargill Grain)	E. McDougall
Nitrochem Inc. (Nitrochem)	R. van Banning

1.7 The following intervened but did not actively participate in the evidentiary portion of the hearing:

Cyanamid Canada Inc., Cyanamid Canada Pipeline Inc. (Cyanamid)	J. Ryan
Denison Mines Limited (Denison)	E. van Jenkle
Eldorado Resources Limited (Eldorado)	E. van Jenkle
North Shore Industries (North Shore)	E. van Jenkle
Rio Algom Limited (Rio Algom)	E. van Jenkle

Energy Probe	D. Poch P. Muldoon
General Chemical Canada Ltd. (General Chemical)	J. Dobson
Inco Limited (Inco)	T. Leishman
City of Kitchener	A. Ryder L. Pare
Michigan Consolidated Gas Company (MichCon)	R. Harrison
Ontario Hydro	L. Formoosa
ProGas Limited (ProGas)	N. Boutillier
Alberta Petroleum Marketing Commission (APMC)	L. Manning

1.8 After registering its appearance on the first day of the hearing, Energy Probe withdrew from the proceeding claiming that, in the absence of advance government funding, it did not have the financial resources to maintain a presence throughout the hearing.

Witnesses

1.9 The following witnesses testified:

For Consumers'

R. G. Riedl	Vice-President, Gas Supply

G. W. Dann	Manager, Gas Supply Western Canada
For Union	
W. J. Cooper	Senior Vice-President, Marketing and Gas Supply
J. C. Hunter	Vice-President, Gas Supply
I. F. Taylor	Associate, Sproule Associates Limited, Consultants
For ICG	
M. A. Wolnik	Vice-President Operations, and Acting Vice-President, Gas Supply and Industrial Gas Utilization
R. W. Reid	Manager, Gas Supply and Planning
T. Best	Corporate Partner, Foster Research, Economic and Management Consultants
R. Wharton	Corporate Partner, Foster Research, Economic and Management Consultants
For WGML	
B. G. Luft	Vice-President of Gas Supply
H. F. Button	Vice-President of Market Planning and Development
T. E. Haynal	Senior Manager, Energy Studies, TCPL

For CPA

W. L. Oostenbrink	Regulatory Affairs Manager, Natural Gas, Mobil Oil Canada
J. M. Dunn	Manager, Regulatory Affairs, Shell Canada
P. M. G. Nettleton	Regulatory Affairs Advisor, Esso Resources Canada Limited

For IPAC

J. G. Schissel	Director
D. R. Sexsmith	Manager, Natural Gas
R. B. Hillary	General Manager, Crude Oil and Natural Gas

For IGUA

T. Bjerkelund	Executive Director
R. G. Drummond	Manager of Purchasing, Polysar

For OAPPPA

R. D. Davis	Assistant Director, Physical Resources, University of Guelph
P. D. Garment	Manager, Operations and Maintenance Utilities and Equipment Division, University of Toronto

For ECNG

R. G. Kirkby	President

For GasPurchase	
P. Kozlowski	President
For North Canadian	
R. D. Smith	Vice-President, Regulatory Affairs
M. D. Callahan	Senior Vice-President and Chief Operating Officer
For Northridge	
D. W. Minion	Chairman
G. L. Spackman	Vice-President, Natural Gas
For Pan-Alberta	
W. J. Litvinchuk	Division Vice-President
R. E. Bowser	Vice-President, Marketing
W. J. Rousch	Vice-President, Gas Supply Department
R.L. Mansell	Professor of Economics, University of Calgary
For Board Staff	
R. T. Liddle	President, Liddle Engineering Ltd.

Interim Report

1.10 On August 19, 1988, the Board issued an Interim Report in this matter to the LGIC (the Interim Report) and recommended that it be made public to assist those industry participants that were then engaged in contract negotiations. The Interim Report was subsequently made public.

Miscellaneous

1.11 Chapters 2 through 9 of this report contain descriptions of each issue and the Board's conclusions and recommendations. In reaching these conclusions and recommendations the Board has considered the evidence, arguments and the written submissions by all interested parties, including the letters from the governments of Alberta and Saskatchewan. The positions of the parties that filed arguments are summarized by issue in Chapter 10.

1.12 The terms used in this report are in common use and it has not been considered necessary to include a glossary. However, the "term" or duration of a contract is subject to different definitions and it should be noted that in this report:

Spot Purchases	- generally one or more months
Short-term	- two years or less
Medium-term	- between two and ten years
Long-term	- ten years and over.

2. PRINCIPLES OF SECURITY OF SUPPLY

Introduction

2.1 Each party was asked to indicate what were, in its view, the pivotal components in security of supply. The positions of the parties on this and all other issues are outlined in chapter 10 of this Report.

Board Conclusions

2.2 The Board concludes that the pivotal components of a secure supply are the availability of gas (commodity) and accessible transmission facilities (transportation capacity) to deliver the gas to the Ontario market. The Board also concludes that, as a principle, appropriate, prudent contracting practices should be encouraged to the maximum extent possible since this can mitigate many supply and capacity risks. Under some circumstances, however, encouragement may not be adequate and the public interest may demand that certain practices be prescribed and enforced.

2.3 The Board's further conclusions and recommendations on the many issues that impact on supply are dealt with in the following chapters.

3. SHORT-TERM SUPPLY ARRANGEMENTS

Introduction

3.1 As noted in the Interim Report, supply is dependent on gas being delivered to the pipeline and on the capacity of the pipeline carrying the gas to its destination. This chapter deals only with gas as a commodity and with the concerns of some parties with respect to short-term contracts. Supply interruptions can occur during the term of a contract if, for example, a well or pool fails temporarily. These interruptions are generally of short duration. A more serious and prolonged interruption may occur, however, if at any time the supplier cannot or will not continue to supply an end user.

Minimizing Risk

3.2 The risks associated with a supply interruption during the term of a contract can be minimized by prudent contracting practices. Several options that are open to the direct purchaser were identified during the hearing. Two of the most effective methods of minimizing risk are diversity and backstopping.

Diversity

3.3 Diversity of natural gas sources enhances supply reliability. Diversity can be achieved through: contracting with a number of producers who hold interests in different gas fields or pools; contracting with a broker who has supply arrangements with a number of producers; or contracting with one producer who dedicates specific reserves of gas that will be produced from several different sources.

Backstopping

3.4 Backstopping provides for an alternative source of gas in the event of the failure of the contracted supply. Some backstopping services are presently offered in Ontario by the LDCs on a best efforts basis, and in western Canada by producers. It was suggested that a corporate guarantee was a form of backstopping. Such a guarantee, however, requires only the payment of money by the delinquent supplier in the event of a failure, but does not assure a continuing supply of natural gas.

Board Conclusions

3.5 The Board accepts that both diversity and backstopping have a role to play in minimizing the risk of supply interruption. Such safeguards are especially important for short-term contracts, since the Alberta Energy Resources Conservation Board (AERCB) and the Saskatchewan Government do not rigorously scrutinize the reserves that support such contracts.

3.6 The Board considers the practice of obtaining critical supplies from more than one dependable source as being a basic, sound business strategy, regardless of the commodity that is purchased or the duration of the purchase agreement. The emphasis that gas purchasers will place on the need for diverse sources of supply will vary depending on the levels of hardship that can result from failures at the well head. Where the avoidance of interruptions is critical, arrangements that provide only financial compensation in times of interruption may be of little comfort to the user who is deprived of gas supply.

3.7 The Board notes that current proposals to increase the interconnections between Ontario and the U.S. will also enhance the diversity of supply.

3.8 In the absence of dependable, diverse sources of supply, some form of reliable backstopping at the producer end of the transmission pipeline is desireable. The more diverse the supply, the less will be the need for backstopping at the producer end of the transmission pipeline.

3.9 Backstopping in Ontario should also be arranged, even if only on a best efforts basis. The Board recognizes that storage is a key element of backstopping and supports the prudent expansion of the LDCs' storage capacity as a means of reducing the risk of supply interruption.

3.10 Evidence was presented at the hearing which supported the expansion of the current storage capability in Ontario as a security of supply measure. While increasing storage is not without cost, the proponents argued that the costs would be modest, and that those who received the protection should pay those costs.

3.11 The Board accepts the principle that storage capability in Ontario should be maximized, provided it is justified as a prudent economic investment. Liquified natural gas (LNG) facilities may be a suitable storage addition, provided that economic, safety and environmental concerns can be satisfied.

3.12 The method of allocating storage costs among customers, if storage is to protect against supply interruptions, will need to be changed since the operation of the storage pools will probably change to some extent. Currently, the objective is to remove all stored gas at the end of the winter season. If some gas is continuously held in storage as a hedge against possible supply interruptions, the allocation of costs becomes more complex. This matter would be dealt with by the Board in future rate hearings.

Board Recommendations

3.13 The Board recommends that the Ontario Government support the concept that each Ontario LDC be permitted to make prudent investments to increase storage capacity for the purpose of backstopping direct purchase volumes.

3.14 The Board further recommends that the current legislation be reviewed and amended where necessary so that prior approval of the Board can be obtained for investment in storage facilities such as an LNG plant. The applicant should be required to demonstrate that tne investment is in the public interest and that the proposed project is economically and environmentally sound.

Other Concerns

3.15 The competence of end users to act appropriately to protect their own interests, without reliance on governments to protect those interests, was questioned by several parties.

Board Conclusions

3.16 The Board has concluded that rapid changes in the industry have resulted in many end users, that previously relied on the LDCs to manage gas purchases, now purchasing their own gas, while not possessing the information, experience or expertise to properly manage this function. This is cause for some concern. Also of concern is the evidence that some direct purchasers in Ontario currently have a perception that the risk of supply interruption is minimal since the government will ensure supply.

3.17 There is clearly a role for government, perhaps through the Ministry of Energy, to undertake the task of making information available to direct purchasers, or potential direct purchasers. Such information might initially consist of general contracting guidelines that should be followed when purchasing gas.

3.18 There are still many uncertainties regarding the pace and direction of future efforts to deregulate the natural gas industry. For example, the impact of the Free Trade Agreement (FTA), the increasing U.S. demand for Canadian gas and the future conduct of the various participants in the natural gas industry, all have yet to be demonstrated. Because of such uncertainties, the Board believes that it will be necessary to periodically review the security of Ontario's natural gas supply and related issues to assess whether the recommendations presented herein continue to be appropriate.

Board Recommendations

3.19 It is recommended that the Board, either at the request of the LGIC, the Minister of Energy of Ontario (the Minister) or on its own motion, undertake periodic reviews of potential supply concerns, either in total or restricted to certain specific issues. After each such review, the Board should submit an updated report containing its conclusions and recommendations to the Minister or such other level of government as may be required by the LGIC.

3.20 The Board also recommends that the Ministry of Energy or an agency of the Ontario Government undertake the publication of general guidelines to improve contracting practices and thereby enhance the security of supply for all Ontario natural gas customers.

4. LONG-TERM SUPPLY ARRANGEMENTS

Introduction

4.1 As in all gas supply arrangements, it is necessary to provide for the delivery of gas from the producer and for transportation to the point of use. Since transportation capacity is dealt with in the following chapter, this chapter will deal only with the arrangements for obtaining gas as a commodity. Supply problems for customers with long-term arrangements can still result from the failure of wells, pipelines, or storage.

4.2 Supply conditions in Canada over the long-term may be affected by the evolution of a "continental" energy market, and by the FTA. It was suggested that increased competition for the currently uncontracted gas in western Canada could affect the availability of gas for the Ontario market.

4.3 An evaluation of long-term security of supply should include consideration of the availability of uncontracted reserves, the current surplus of natural gas, and the forecasts of when supply and demand are expected to come into balance.

Continental Market/Free Trade

4.4 During the hearing it was suggested that, although the restrictions on natural gas trade between Canada and the U.S. are diminishing, the development of a continental market is far from assured. Some anticipate, however, that the FTA may represent a major step in that direction.

4.5 Concern was expressed that implementation of the FTA, together with legislative changes, would exacerbate apprehensions raised by the diminished role of the National Energy Board (NEB) with respect to export applications. It was noted that control over export licences would effectively shift from the NEB to the Federal Government.

4.6 A further concern was the proportionality clauses contained in the FTA. These are triggered in the event of a gas shortage and provide a proportional reduction in gas deliveries to both Canadian and export markets, based on the preceding three years' consumption.

Board Conclusions

4.7 The Board accepts that a continental market for natural gas in North America has not yet become a reality. The Board also accepts that the FTA, if and when it is implemented, will certainly be one of the building blocks towards achieving the continental market. Currently, however, there are a number of political and regulatory hurdles which may be insurmountable and prevent such a market from becoming a reality.

4.8 Having considered all of the concerns that were expressed with respect to the potential impact of the FTA, the Board has concluded that the proportionality clauses may be cause for concern. The Board's concern is that prorationing of supplies could impact on Ontario customers far more severely than on U.S. users.

4.9 The Board notes that a long-term contract provides no security against supply reductions as a result of prorationing.

4.10 While the NEB may no longer provide protection for supplies of gas to Canadians, the Board agrees with the Director that this responsibility remains with the Government of Canada. Under the proposed new legislation, the Federal Cabinet will be held responsible for ensuring that Canadian natural gas is available for Canadians.

Long-Term Contracts in Other Market Areas

4.11 Some claimed that long-term security of supply in Ontario will be affected by the demands of other major markets for western Canadian gas. The evidence was that U.S. customers are entering into long-term contracts with Canadian producers, thereby reducing the uncontracted volumes available to other purchasers, including those in Ontario. One such example is the contract between Pan-Alberta and Southern California Gas Company (SoCal) for a 24 year supply.

4.12 Some argued that there is a general trend toward long-term contracts which should be an indication to Ontario customers that they too should be prepared to enter into long-term commitments for gas supply, while uncontracted supplies of gas are available. It was advocated that a core market should be defined, as other jurisdictions have done, and that those customers who are considered core should only be permitted to obtain gas supplies under long-term contracts.

Board Conclusions

4.13 Extensive information was presented explaining how other jurisdictions have chosen to deal with their long-term natural gas supply concerns. The Board acknowledges that certain jurisdictions have defined a core market, in some cases with the LDCs having exclusive franchises to supply that market from long-term contracts, and in others with core customers being restricted to purchasing gas under controlled conditions.

4.14 The Board has also noted the very strong recommendations by some of the participants that this Board should follow the example set by these other jurisdictions, presumably on the basis that those jurisdictions recognised a potential problem and acted appropriately.

4.15 Having reviewed the evidence, the Board notes that, although there may be some similarity among the approaches taken by the jurisdictions cited by the parties, there are also a number of significant differences. The definition of the "core" varies, and the restrictions on core customers making direct purchases are different. The intent of the action taken by each jurisdiction may well be different. This is to be expected since the public interest, as perceived by each jurisdiction, will vary. A jurisdiction which is a significant exporter of natural gas will likely have priorities which may conflict with those of a consuming jurisdiction.

4.16 The Board also notes that most of the measures referred to have only recently been introduced. There has been little experience with any of them, and insufficient time to evaluate their effectiveness. The jurisdiction most referred to by the proponents of long-term contracts for essential service customers (ESCs) was California, which was also one of the first to introduce rule-making defining a "core" market. It is interesting to note that since the close of the hearing, California has issued a new Proposed Rule Making which contains a significant change in direction.

4.17 Whereas the thrust in California has been towards long-term contracts for supplies to the core market, the California Public Utility Commission (CPUC) is now proposing that all contracts over five years require CPUC approval, and each contract must include a "regulatory out" clause such that, in the event that circumstances change, the LDC can abrogate the contract without penalty.

4.18 The Board has concluded that the actions of other jurisdictions must be viewed with caution because of the different public interests, and because there has been insufficient experience to recommend one approach over another.

4.19 The Board will base its recommendations primarily on an evaluation of the Ontario public interest as it relates to the long-term supply of natural gas.

Supply/Demand Balance and Impact on Uncontracted Reserves

4.20 According to the evidence, there is presently a surplus of natural gas in Canada which has depressed gas prices through gas to gas competition. The competitive market should, however, balance supply and demand in the long term through the pricing mechanism. The price of natural gas will also have an impact on the level of exploration for, and development of, additional gas reserves in Canada.

4.21 The evidence was that there is approximately 60 Tcf of proven economic reserves in Alberta, and 2 Tcf of proven economic reserves in Saskatchewan. Of these volumes, approximately 10 Tcf are uncontracted and available to Ontario and other consumers. There was no suggestion by any of the participants that the above figures represent the total of all the gas that lies beneath Canadian lands, or that more gas cannot be found in either Alberta or Saskatchewan. It was noted, however, that current drilling activity in North America is very low.

4.22 Some of the participants noted the increase in exports to the United States and the increasing interest by U.S. customers in purchasing Canadian gas under long-term contracts. They claimed that Ontario consumers could soon find that all the available gas had been contracted to U.S. customers, and there was little or no uncontracted gas remaining to meet the demands of Ontario customers.

4.23 The above situation was cited by many of the participants as the reason why at least the ESC group should be protected by long-term contracts. It was generally argued that the larger industrial customers were sufficiently sophisticated and knowledgeable to look after themselves, but the smaller customers and the ESCs needed protection because they lacked sufficient knowledge and sophistication. Some participants claimed that all but the large industrial customers need to be protected against themselves, otherwise there will be shortages of gas in Ontario.

4.24 There were predictions during the hearing as to when the overall Canadian supply and demand for natural gas would be in balance or, in other words, when the current surplus of gas in Canada would be eliminated. The opinions expressed were that a balance might be achieved around the year 2000.

Board Conclusions

4.25 The Board considers it improbable that in the near future U.S. customers will contract for all available Canadian gas, leaving no gas for Ontario. While the Board recognises that natural gas is a finite resource, there is no evidence that Canadian supplies are at an end, or that all sources of gas have been identified and quantified. As supplies tighten, price will increase, making further exploration and development viable even in areas where it is currently uneconomic.

4.26 The Board accepts that the development of reserves may not always be possible without a long-term contract to justify the investment. If that is the case, the decision by a customer to enter into a long-term contract, and the producer to develop the reserves, should be based on a commercial arrangement accepted by both parties as being in their interests, not by government mandate.

4.27 The Board found no evidence to suggest that price will not be a satisfactory allocator of gas, provided the market is allowed to function freely without distortion or artificial restrictions. Thus, price will determine the availability and allocation of Canadian gas among those consumers who are able to arrange transportation from western Canada. Unless the current capacity constraints on most pipelines are eliminated, it is difficult to accept that U.S. customers will be able to remove the large volumes of gas from Canada that some of the participants were suggesting.

4.28 In the present surplus situation, long-term contract prices are virtually the same as short-term contract prices. The term of the Pan-Alberta contract with SoCal was extended significantly with no change in price. The Board notes that the extension of that contract appears to indicate that Pan-Alberta is prepared to hold significantly more gas in inventory against this contract, without any added compensation other than a committed market at market price.

4.29 Based on the evidence, the Board has concluded that, although the current surplus may disappear, adequate volumes of western Canadian gas will be available for some time to come. Price will determine the availability of gas and since long, medium and short-term contracts are being executed with the price fixed for a maximum of only two years, there is little incentive for a customer to commit for a long-term supply. Although a long-term contract with dedicated reserves will provide a customer with assurance that supplies will be available, the major advantage currently flows to the producer since not only is the market assured, but the price will reflect the market price throughout the life of the contract.

4.30 The Board accepts that an Ontario direct purchaser holding a long-term contract with dedicated reserves has a greater security of supply than one that is purchasing on a spot, short or medium-term basis. Given the dynamics of the current environment, the Board concludes that all purchasers should be encouraged to consider the longest-term competitive arrangement that each can justify.

4.31 The Board cautions that, in reaching its conclusions, it has relied on today's circumstances and short-term forecasts. Given that the natural gas industries and markets in both Canada and the U.S. are in a state of flux, unforeseen events can occur and undermine or invalidate even the most astute prognostication.

Board Recommendations

4.32 The Board recommends that, on the basis of the availability of gas, the LGIC should take no action to force any Ontario customer or customer groups to buy gas under long-term contracts.

4.33 Similarly, although information should be made available to prospective direct purchasers as to the need for dedicated reserves and the monitoring of deliverability, the Board recommends that no action be taken by the LGIC at this time to impose any such standards on Ontario customers.

4.34 The Board further recommends that, while long-term contracts and contract terms should not be mandated, direct purchasers, and particularly LDCs, should be encouraged to enter into the longest-term contracts that can be justified on the basis of price and other business considerations as a means of minimizing supply risks.

5. TRANSPORTATION CAPACITY

Introduction

5.1 The term "transportation capacity" refers to the physical capacity of the natural gas systems to transport gas. An assessment of capacity involves considering such factors as constraints on the existing facilities, the design of the systems, as well as renewal and reversion rights. Transportation capacity is an essential element of security of supply since the facilities must be in place to transport the commodity to market. Building additional capacity into a pipeline system requires a lead time of approximately two years.

5.2 The issues of renewal and reversion result from the Operating Demand Volume (ODV) mechanism in use by the NEB for the TCPL system. Direct purchase customers with transportation capacity on the TCPL system can only utilize that capacity for their own needs. If an agreement for such capacity expires, or is renewed by the direct purchaser for a reduced capacity, the reserved pipeline capacity made available goes to the next applicant in the queue for TCPL pipeline space.

5.3 Consumers' proposed that enough pipeline capacity should be under contract to an LDC to meet the current and reasonably foreseeable needs within its market area. In order to ensure that adequate capacity is dedicated to each LDC, it proposed the following:

- The LDC would assess and contract for the difference in capacity requirements between the direct purchasers' transportation contracts and the total capacity demand of its franchised area.

- After the prudence of such pipeline contracts has been assessed by a regulatory body, the LDC would be allowed to recover the associated incremental fixed costs through its cost of service.
- The LDC would be obligated to sublet any unused pipeline capacity, without discrimination, to any shipper/end user in its area.

Board Conclusions

5.4 In order to explain the Board's reasoning with respect to capacity on the pipelines that carry the gas from the wellhead to the end user, the possible causes of failure should be understood. There are at least four pipeline-related situations which can result in a failure of gas supply.

5.5 Firstly, a malfunction may occur in one of the pipelines that comprise the links between the wellhead and the customer's point of receipt. The supply would be interrupted and all contracts, including firm and interruptible, would be abrogated temporarily by a declaration of force majeure by the transporter. These events can be catastrophic, but fortunately they are rare and are usually of short duration.

5.6 Secondly, capacity may not be available as required by a purchaser as a result of a failure to contract wisely. This can be due to a failure to identify the risks adequately. It can also result from a gamble that interruptible capacity will not be interrupted. A failure to forecast demands accurately can also result in a shortfall in the needed capacity.

5.7 Thirdly, there are a number of regulatory restrictions that impact on the ability of a purchaser to ensure that capacity is available to carry gas from wellhead to burner tip. For example, in the event that a direct purchaser decides to return to purchasing gas from the LDC, the direct purchaser is currently prevented from transferring its transportation contracts to the LDC. In the event that the LDC does not have sufficient capacity, the direct purchaser would be precluded from the option to discontinue a direct purchase.

5.8 Fourthly, most of the pipeline capacity upstream of Ontario is currently fully contracted, so the potential to increase volumes substantially on short notice is limited. Any purchaser of gas must, therefore, forecast growth far enough into the future to allow lead-time for the regulatory process and the installation of facilities to provide increased capacity.

5.9 In the event of a failure of any section of the pipeline, the resulting impact can be anything from mild inconvenience to a catastrophe. In the latter case, the contracts are of little assistance since all parties would work together to minimize the impacts. The Board understands that an emergency plan is in place which presumably would attempt to maintain supplies to those who are most dependent on gas. A pipeline disruption of a catastrophic nature could, of course, result in the interruption of all gas supplies. In that event, the LDCs would be unable to supply gas, regardless of pressure from the Ontario Government or this Board.

5.10 Earlier herein the possibility of supply failure due to a malfunction at the production end of the pipeline was cited. It was noted that some protection can be achieved through backstopping arrangements which would require other producers to deliver substitute gas to the pipeline. This can only be achieved, however, if there is pipeline capacity from the new point or points of supply to the main transmission line.

5.11 The Board has concluded that, although this does not require government action, Ontario's direct purchasers should be advised to ensure that any backstopping arrangements entered into, either by or on behalf of the purchaser, are such that the backstop supplier(s) can deliver the gas, even in periods of peak demand.

5.12 The evidence supported the claim by a number of participants that some Ontario direct purchasers have the perception that the LDC, either with or without pressure from the Government, or this Board, will be forced to provide gas in the event of a failure of the direct purchase supplies. The Board agrees that such a perception would probably lead to poor contracting practices since the need to offset risks would not be paramount. As noted above, there are circumstances under which the direct purchaser cannot protect itself, but there are others where prudent contracting can avoid problems. It is important that information be disseminated to assist those contracting for gas supply.

5.13 Most of the gas entering Ontario for direct purchasers is flowing under transportation contracts with TCPL for two years duration or less, and the current practice permits each customer to extend the transportation contract on expiry. If, however, a customer terminates a contract, or reduces the volumes under that contract, the pipeline capacity thus released on the TCPL system goes to the next customer in the queue, regardless of whether that customer is in Ontario, another Canadian province or the U.S.. Gas supplies for the LDCs are mainly under longer-term transportation contracts with TCPL, and there is no transportation risk for these volumes. A relatively small volume of gas is purchased by each LDC under other short-term arrangements and under TCPL's interruptible tariffs. The risks associated with these volumes are very small.

5.14 The Board has concluded, however, that there is reason for concern that, under current circumstances, the ability to transport some volumes of gas from western Canada to direct purchasers in Ontario could be at some risk in the near future. A direct purchaser who may, for any reason wish to return to the LDC for supplies, may be prevented from doing so because of the inability of the LDC to obtain capacity on the upstream pipelines. A direct purchaser may want to return to the LDC, for example, if a current supplier cannot, or will not, extend a contract, and the purchaser is unable to contract for transportation from the point of any new supply.

5.15 The Board has carefully considered the risk of the loss of at least a portion of the gas supply to Ontario's direct purchasers due to transportation limitations, and has concluded that some action is required. Several methods of offsetting the risk were assessed, including allowing some, or all of the customers, to make their own choices on the basis of guidelines prepared by the Ministry of Energy. As noted earlier, however, there is some concern that all customers would not act in a prudent manner, even if provided with information identifying the risk involved, and guidelines as to how to offset the risk.

5.16 The Board has concluded that, under current circumstances, the risk should be offset, and the need for government intervention to deal with shortages of gas should be minimized. This can be accomplished by imposing a requirement on all direct purchasers that they have adequate transportation contracts in place for a minimum term.

5.17 There appeared to be a consensus that the time required to complete the necessary formalities and install additional pipeline facilities is approximately two years. Since two years appears to be the minimum notice required, a three year rolling contract, with the third year negotiated annually, would meet those requirements.

5.18 The Board recognizes, as did essentially all parties to the hearing, that customers that can burn alternate fuels, or are less critically dependent on natural gas, may be able to contend with the risk of an interruption in their ability to transport gas. While the Board holds that a general requirement for a minimum three year rolling contract is appropriate, exemptions should be available, on application, to those end users that are aware of the risks, can accommodate interruptions and can accept any hardships that may result, so long as their decision does not impose onerous risks on others.

5.19 There appears to be little doubt that the pipeline capacity from the wellhead to Ontario is currently almost fully contracted. Therefore, although some gas can probably be carried on an interruptible basis, it is almost impossible to obtain a contract for the firm delivery of additional gas.

5.20 In view of the above, the Board supports the LDCs' proposal that more flexibility be permitted in the contractual arrangements for the delivery of gas to Ontario. The LDCs' proposal was that the capacity released by any customer within a franchised area should first be offered to the LDC, and that the LDC be permitted to contract in advance to accommodate forecast growth in its franchised area.

5.21 The LDCs sought comfort from the Board and the Ontario Government that any costs associated with the additional capacity would be recovered from gas customers, and that their shareholders would not be placed at risk for these costs. The Board has concluded that it should endorse the LDCs' proposal that the prudently incurred costs should be recovered from gas customers. However, the Board considers that the LDCs' shareholders should continue to be at risk for variations from the LDCs' forecasts on which rates are based. Any costs that result from excess capacity would be recovered from customers only if the forecast of growth that led to the excess capacity had been found reasonable. The impact of changes in weather and the economy will continue to be for the shareholders' account.

Board Recommendations

5.22 The Board recommends to the LGIC that:

1. the LDCs be prohibited from entering into a transportation agreement with a direct

purchaser, or a buy/sell arrangement, that does not have adequate transportation for a minimum of a three year rolling term, unless prior Board approval is obtained for any contract with a shorter term;

2. the Board be authorized to approve the transportation of gas under a contract of less than three years, with or without a hearing, after considering questions such as the following:

   - Can the customer withstand a sustained interruption?
   - Are the gas volumes significant?
   - Do the contract terms and conditions assure delivery over the life of the contracts?
   - Would Government or the Board be expected to order that supplies be made available in the event of a failure of the customer's supply?

   - Would there be a material impact on the public interest if a supply interruption occurred?

3. the Board develop an approval or exemption process to deal with those customers that can provide assurance that operating with

a contract of less than three years can be tolerated and will not adversely impact on the public interest or impose a risk on other gas customers;

4. the Board be authorized to establish criteria against which the LDC shall assess transportation contracts to determine whether they meet the minimum requirements for a transportation customer. These shall include, but not be limited to:
   - that the terms and conditions of the contract are such that the customers' requirements will be met;
   - that the term is three years or longer;
   - that appropriate upstream transportation contracts are in place for the life of the contract with the LDC;

5. the LDCs be required to make available any excess capacity to any direct purchaser or other LDC that can substantiate a need. Such sub-contracting of capacity must be on a cost recovery basis. When evaluating the costs of any excess capacity that an LDC wishes to recover through rates, the Board will examine the efforts of the LDC to dispose of excess capacity; and

6. current legislation be amended to provide the Board with the authority to implement the above recommendations;

7. since the LDCs cannot implement their proposals with respect to upstream transportation capacity until certain regulatory practices outside Ontario are changed, the Ontario Government should actively promote these changes with the governments and agencies involved.

6. MARKET SEGMENTATION

Need for Segmentation

Introduction

6.1 The issue is whether there is a need to segment the consuming market in Ontario in order to differentiate between customer groups on the basis of the need for guaranteed supplies of natural gas. The terms "core" and "non-core" have been used by some in segmenting the market, with core customers generally being those non-industrial users that have no ability to employ alternative fuels, and rely on gas for space heating. In other jurisdictions, controls have been imposed that dictate how each segment will be served and, in some cases, which suppliers can serve them.

6.2 The Board, in its Contract Carriage Decision E.B.R.O. 410-411-412, dated March 23, 1987, defined the core market as being all those customers, except buy/sell customers, who continue to purchase gas from the LDC. The Board also stated that customers should be free to choose from among those willing to supply them without restriction on the basis of end use.

6.3 The term Essential Service Customer (ESC) was introduced by Consumers' and was adopted by many of the participants essentially as a substitute for "core customer". Opinions as to which customers should be considered ESCs varied.

Board Conclusions

6.4 Throughout the hearing there was considerable confusion between the need to protect certain customers against a possible supply interruption during the period when a contract is in effect, and the concern that a customer will be unable to negotiate the continuation or extension of an existing direct purchase contract.

6.5 If a widespread supply interruption occurs as a result of a malfunction of equipment or production facilities, the contracts would carry little weight in determining which customers would receive gas since the industry as a whole would strive to minimize the impact of the supply failure.

6.6 As Mr. Riedl of Consumers' indicated, contractual conditions do not prevent such an occurrence, nor do they establish any priority position or provide a contract holder with any rights. He said:

> I think we cannot talk about accidents or natural disasters or acts of God, because in those instances, we leave the contracts in the drawers and we just make sure that people who should get gas, get gas.

6.7 Those that claim that governments might interfere under such circumstances perhaps expect that governments might attempt to ensure that certain customers are accorded the highest priority and are interrupted last. If gas is not available, no government can ensure that any customer will receive gas.

6.8 It is obvious that such an interruption is beyond any situation where those who have prudently contracted for gas might find their supplies taken for delivery to those who have been imprudent in their contracting practices. As Mr. Riedl said, the contracts stay in the drawers.

6.9 The Board accepts that there are differences among gas users in the level of their knowledge and experience with respect to the gas industry and contracting practices. There are, however, a number of reputable consultants, brokers, producers and LDCs that are able and willing to assist a potential direct purchaser that may lack some of the knowledge and experience required.

6.10 The Board has concluded that knowledgeable and experienced personnel are not located solely with customers who have alternative fuel supplies, or with large volume industrial or commercial gas users. The Board is satisfied that there is adequate knowledge and experience available to any would-be direct purchaser and, as a result, there is no necessity for market segmentation on the basis of a lack of knowledge, sophistication, or experience.

6.11 With respect to the renewal of contracts, the Board, in its Interim Report and elsewhere herein, has concluded that natural gas is available in western Canada, and will be available for the forseeable future at market prices. Currently essentially all purchase contracts for natural gas are on a one to two year price term. With renegotiation, indexing or arbitration to determine the price for subsequent years, it appears that all gas purchased for Ontario will effectively be at market prices. The use of long-term contracts, therefore, does not assure any customer or customer group a more stable price compared to those on short-term contracts. The Board, therefore, concludes that market segmentation cannot be justified on the basis of achieving price stability or lower prices.

6.12 The Board finds no compelling evidence upon which to recommend to the LGIC that any customer should be prevented from seeking gas from other sources, either individually or as a member of a group. The Board is satisfied that the requirement for a minimum transportation contract term of three years, combined with the safeguards referred to earlier, should provide assurance of supplies to Ontario consumers.

6.13 The Board is of the opinion that the majority of those customers, that some would classify as ESCs, will remain as customers of the LDCs. This, however, does not justify limiting their choice of supplier. The Board considers that the imposition of such a limitation would be in violation of the intent of The Agreement on Natural Gas Markets and Prices.

Board Recommendations

6.14 The Board recommends that the Government refrain from defining a core market and that no limitation be imposed on any customer as to the choice of supplier.

7. SECURITY OF SUPPLY MEASURES

Introduction

7.1 Long-term and short-term contracts were compared by the participants with respect to the relative merits of each in providing a secure gas supply. Other considerations were the natural gas supply and demand balance, the availability of transportation facilities, and the terms of the contract, including pricing.

Board Conclusions

7.2 The Board accepts that a long-term contract does offer security of supply, however, the evidence created serious doubt as to whether, under current market conditions and those expected to prevail for the next three to five years, the security of supply associated with a short-term contract would be much less.

7.3 With a surplus of gas, or even with supply and demand in balance, customers should be able to extend and even expand existing contracts. As and when the supply situation tightens and higher prices prevail, longer-term contracts may become more attractive.

7.4 The Board accepts the characterization by some of the participants that long-term supply contracts with take or pay provisions were the "flywheel" which underpinned the development of the natural gas industry and satisfied the need for financial assurances. In most cases, when those long-term contracts were entered into, there was a fixed price for the term of the contract so that price stability was assured.

7.5 The market situation today is substantially different in that the market is firmly established and, to a large extent, only incremental changes are involved in increasing capacity or extending pipelines. It appears, therefore, that there is no longer the need for the "flywheel" as there once was. Today it appears that producers are reluctant to commit to a price for longer than approximately two years. The result is that a price adjustment mechanism is required either through negotiation, indexation or arbitration.

7.6 The Board has concluded that the advantage of long-term contracts appears to rest disproportionately with the producer in that there is an assurance of market and an assurance that price will be periodically adjusted to the market price. The customer has an assurance of supply, but in the current situation of surplus, or even in a balanced market, that assurance has little value if the price reflects no discount for the commitment made by the customer.

7.7 It was argued that the producers will not invest in exploration, and particularly development, without long-term contracts. This statement appears to be contrary to the functioning of a normal competitive market where the production of goods inevitably precedes the development of the market. In the case of gas production in western Canada, there is every evidence that the producers are intelligent businessmen who will monitor the market and, as supplies tighten, expand their activities to meet the perceived demands of the future. If a producer finds it necessary to have a long-term contract in order to develop a particular producing area, that producer can persuade customers to enter into long-term contracts through whatever incentives are required.

Board Recommendations

7.8 The Board recommends that the Ontario Government take no action to mandate that customers enter into long-term contracts on the basis of security of supply.

Contract Terms and Conditions

Introduction

7.9 The terms of a contract can affect the supply security provided to the end user. The length and form of the contract, the dedication of reserves, and/or a corporate guarantee for deliverability all affect security of supply.

Board Conclusions

7.10 Given the relatively enormous U.S. appetite for natural gas, and the increased ability of Canadian producers to access the U.S. market, the Board recognizes it is possible that the uncontracted reserves of Canadian gas could conceivably become dedicated to U.S. markets. While additional reserves would undoubtedly be brought on-stream in response to any dramatic increase in demand, it is possible that there may be a lag in the time required to effect this. It is, therefore, conceivable (but unlikely) that the Ontario market might encounter a period during which supply is temporarily restricted.

Board Recommendations

7.11 The Board recommends that the LGIC consider that Ontario unilaterally, or in cooperation with the Federal Government, commission a study to consider the need and economic costs/benefits of establishing a strategic reserve of natural gas to cushion domestic users during intervals of supply shortage. It is expected that such a reserve would be outside the FTA.

7.12 The Board would further recommend that, if such a reserve is established, it be located within, or in close proximity to Ontario to avoid any problems associated with removal authorizations by producing provinces, and to assure its availability in the event that disruptions on the NOVA and TCPL transmission systems are the cause of the supply shortage.

Market Access and Obligation to Supply

Introduction

7.13 Section 54 of the Public Utilities Act, R.S.O. 1980, c.423, states:

> Where there is a sufficient supply of the public utility, [natural gas] the corporation shall supply all buildings within the municipality situate upon land lying along the line of any supply pipe, wire or rod, upon the request in writing of the owner, occupant or other person in charge of any such building.

7.14 The obligation to supply contained in this section has been interpreted in many different ways, especially with respect to direct customers wishing to return to the LDCs for their gas supply.

Board Conclusions

7.15 The Public Utilities Act, as currently written, clearly imposes an obligation to serve, limited only by the LDC's ability to serve. It does not differentiate between customers.

7.16 The Board has concluded that it would be contrary to the intent of the Public Utilities Act to differentiate between new and returning customers with respect to access, and that it would be unduly discriminatory to impose special costs in the case of a recontracting customer. All customers added to an LDC's system without adequate notice may be liable for the costs associated with serving that customer. At each LDC's next rate proceeding appropriate treatment will be decided for such customers.

7.17 Given that the LDC's obligation is limited to a best efforts basis, it appears obvious that potential customers and customers intending to return to the LDC's system would be well advised to provide as much advance notice as possible to assure that the LDC will be in a position to provide service at the lowest cost.

Board Recommendation

7.18 The Board recommends that the LGIC take no action with respect to the obligation to supply, and that the Public Utilities Act, as written, will continue to govern these situations.

8. MARKET IMPACT FROM SECURITY OF SUPPLY MEASURES

Relative Price Among Groups

Introduction

8.1 When approving or fixing just and reasonable rates for an LDC the Board assesses price to ensure that there is no undue discrimination among customer groups. The issue in this proceeding was whether the proposals of the LDCs as to portfolios of gas supply would lead to price differentials between customer groups and, if so, whether they could be justified.

Board Conclusions

8.2 The Board has concluded that it should not recommend a legislated market segmentation. Therefore, any relative price differentials should be as a result of market forces, and not as the result of regulatory interference.

8.3 The Board notes ICG's recommendation that the LDCs be allowed two gas purchase portfolios so that the differences in load factor and the cost of supply security could be identified and passed on to each group.

8.4 The Board has some concern with the use of two portfolios and two weighted average cost of gas (WACOG) for an LDC's gas supplies. It is recognised that ICG presented only an outline of its proposal, but the Board assumes that the sales customers of the LDC would be separated into two groups (ESC and non-ESC) for purposes of gas costs.

8.5 The Board concludes that this approach would lead to difficulties in tracking costs and volumes, and that separating the purchasing could result in an overall increase in costs due to a reduction in the efficient use of transportation.

8.6 The Board has concluded that, with only one portfolio of supplies, load factor, supply security, and other characteristics that determine the quality of service required by each customer class can be assessed and the cost implications reflected through allocation. In effect, a different cost of gas would be determined for each rate class by allocation, on the basis of quality of service, from the total cost of the single portfolio of gas purchases.

8.7 The Board further concludes that a flexible approach is required with respect to any costs that may result from loss of sales caused by customers selecting the direct purchase option. The Board may, if requested, establish deferral accounts to ensure equitable treatment of such costs.

8.8 Such action falls within the current jurisdiction established by the Act, therefore, no changes to the legislation are required.

8.9 The Board notes that the authority for the Board to assess the prudency of an LDC's portfolio is provided under Section 19 of the Act.

Board Recommendations

8.10 The Board recommends that the LGIC recognize the LDCs as being in the best position to assess the requirements of their own franchise area. Each, therefore, should be responsible for deciding on an appropriate portfolio, and for negotiating with WGML and other suppliers. The Board, therefore, further recommends that the government should take no action with regard to specifying a portfolio for an LDC.

Competition Among Suppliers and Market Access

Introduction

8.11 The Board, in Reasons for Decision E.B.R.O. 410-411-412 dated March 23, 1987, "...endorsed the development of a competitive market in Ontario which requires that there be an equal opportunity among potential suppliers...". The issue examined was whether any of the proposed measures to protect the security of supply for Ontario consumers, would inhibit competition in the market, or restrict market access.

Board Conclusions

8.12 The Board continues to endorse the development of a competitive market for natural gas in Ontario with equal opportunity among suppliers to contract with any purchaser.

8.13 The Board concludes that its recommendation of a minimum term for direct purchase contracts, unless an exemption is granted or a shorter term is approved by the Board, does not impose any constraint on either the purchaser or the seller that would restrict access or inhibit competition.

9. ARBITRATION PROVISIONS

Introduction

9.1 Most long-term contracts currently being negotiated for natural gas supply ensure an ongoing supply, and allow the price for natural gas to be redetermined on a regular basis to reflect the state of the marketplace. Producers and customers are generally reluctant to commit to long-term fixed pricing provisions, since these prices may not be competitive over time. While most price adjustments are expected to result from negotiations, some contracts contain binding arbitration provisions as a contingency in the event that the contracting parties fail to negotiate an agreement. However, the Ontario LDCs are currently tied into contracts with WGML/TCPL which do not contain arbitration provisions. Some were of the opinion that the lack of such provisions threatens the security of supply and the well-being of Ontario customers.

9.2 There were suggestions that future contracts between the producers/WGML/TCPL and the LDCs will contain a binding arbitration clause.

9.3 There are several factors to be taken into account when considering arbitration clauses. These include the language of an arbitration provision; the pros and cons of arbitration; the level to which Ontario and Alberta would be bound by the arbitration, and if the arbitration is binding, whether just and reasonable rates can be set in a manner consistent with current Ontario legislation.

Board Conclusions

9.4 The Board recognizes the concern of a number of participants that, unless the Board is bound by the results of the arbitration process, it will impose a further layer of uncertainty in the contracts. However, the Board has concluded that, given the current state of deregulation, the public interest requires that all costs imposed on the LDCs' customers should continue to be subject to Board review and approval.

9.5 The Board, therefore, concludes that, although it may agree to the language of an arbitration clause, such agreement should not be construed as a pre-approval of the results of an arbitration. It has also concluded that it would be inappropriate for the Board to be directly involved in an arbitration process.

9.6 The Board wishes to make it clear that it has no bias against any arbitration clause or arbitration process. As indicated above the Board considers that it should continue to scrutinize costs and, assuming they are shown to be prudently incurred, those costs will be approved for inclusion in rates. This will be true regardless of the process that was employed in the determination of those costs.

9.7 The Board will neither recommend nor reject the use of arbitration provisions in contracts for gas supplies to Ontario LDCs and customers. The inclusion of an arbitration clause in any commercial contract should be as a result of the negotiating process, and should not be mandated nor precluded by a regulatory body or government.

Board Recommendations

9.8 The Board recommends that neither the Ontario Government nor this Board be bound by the results of an arbitration of a natural gas contract. The Board further recommends that the LGIC continue to rely on the Board's review of an LDC's cost, as currently provided under the Act, in order to ensure that such costs have been prudently incurred and are in the public interest.

10. POSITIONS OF THE PARTIES

10.1 Principles of Security of Supply

The LDCs

10.1.1 Consumers' submitted that sufficient reserves of gas are available to meet the current and future needs of Ontario consumers, as long as prudent contracting practices are maintained. It recommended that each LDC should be responsible for the maintenance of adequate pipeline capacity to serve its franchise area, and the transportation system must be regularly expanded to match Ontario's future requirements.

10.1.2 Consumers' also suggested that an ESC group be defined as those customers who depend on natural gas in such a fundamental way that government intervention could be expected on their behalf in the event that a supply shortage seemed imminent.

10.1.3 Consumers' further submitted that "supply security standards" should be established for all parties that supply the ESC group, and that the Board should monitor or approve all contracts to supply the ESCs. The standards for supply security should include long-term contracts with dedicated reserves, the required diversity of supply and firm pipeline capacity.

10.1.4 Union agreed with the concept of an ESC group, and submitted that a portfolio of contracts extending over different terms would provide both security of supply and reasonable prices. Union also submitted that ESCs should be able to enter direct purchase arrangements subject to OEB approval. Such arrangements should include a rolling three year term with dedicated reserves and firm transportation service.

10.1.5 Union supported Consumers' recommendations regarding pipeline capacity and suggested that additional storage be developed to enhance backstopping abilities. Union further submitted that Ontario should contract for, or buy, its own natural gas reserves from western Canada to guard against potential future shortages.

10.1.6 ICG also endorsed the definition of an ESC class, with adequate contractual practices being required to provide sufficient protection to this group. ICG submitted that the OEB should be able to enforce prescribed guidelines which would apply to ESC supplies from both LDCs and others.

The Brokers

10.1.7 The brokers were concerned with the distinction between reliability of deliveries and security of supply. The brokers submitted that direct purchase arrangements are no less reliable than the LDC's contracts.

10.1.8 The brokers supported the combination of the free market system and prudent contractual practices as the best mechanism to ensure security of supply for all end users. The brokers submitted that in a deregulated market, natural gas will always be available if the end user is willing to pay the market price. They held that a competitive market cannot be established if overly restrictive contracting requirements are imposed on Ontario customers.

10.1.9 ECNG supported Consumers' position that the LDCs be allowed to contract for additional firm transportation on TCPL's system to allow greater market flexibility and security.

10.1.10 Northridge submitted that the Ontario LDCs and WGML/TCPL should not burden the Ontario market with anti-competitive long-term contracts any longer.

10.1.11 Ocelot suggested that the Ontario LDCs should provide additional storage to underpin the direct purchase market. Ocelot submitted that, as this segment has thus far shown itself to be knowledgeable and prudent in its contracting practices, there should be no constraints placed on it or any other consumer group.

10.1.12 Pan-Alberta differed from the other brokers in that it supported the concept of ESCs and the imposition of contractual standards to supply this group. Pan-Alberta argued that, should the ESCs suffer a supply shortage in the future, government intervention would be inevitable. This would threaten the free market system. Therefore, Pan-Alberta endorsed Consumers' concept of security of supply standards which would require dedicated gas supplies for ESCs and contracts of 10 to 15 years.

The Producer Associations

10.1.13 CPA submitted that freely negotiated contracts in a competitive marketplace between prudent parties that are aware of the inherent risks in their supply decisions are the best means for satisfying their supply requirements.

10.1.14 IPAC submitted that the best assurance for future supply is achieved through a competitive industry with long-term contracts backed by dedicated reserves and sufficient deliverability. IPAC submitted that regulatory supervision should ensure that the ESCs never suffer the risk of gas failure, as they are dependent on a secure supply.

Consumers and Consumer Associations

10.1.15 IGUA, CIL, and Nitrochem endorsed the principle of an open market, and submitted that appropriate contractual practices in a fully competitive marketplace should be sufficient to provide adequate supply. IGUA and CIL argued that customers who choose to enter direct purchase arrangements should be responsible for ensuring that the degree of security is appropriate for their needs.

10.1.16 IGUA further submitted that the consuming provinces should establish a security of supply policy for their customers, and that only these provinces should impose any standards they consider appropriate.

10.1.17 Maple Leaf Mills and Cargill Grain both supported the concepts of an ESC group and security of supply standards for those supplying that group.

10.1.18 OAPPPA submitted that security of supply should consist of adequate uncommitted reserves held by financially sound producers, with adequate transportation facilities to handle foreseeable needs.

WGML

10.1.19 WGML submitted that customers tend to focus on short-term supply, and rely on the actions of the government for adequate long-term supplies. WGML held that if the Board fails to set security of supply standards now, it will essentially be perpetuating this perception. Therefore, WGML supported the establishment of contracting guidelines for ESCs.

The Director

10.1.20 The Director submitted that security of supply lies in balancing supply and demand in response to price signals in a competitive marketplace. He held that the principles of security of supply are the principles of competition, in that the more competitive the marketplace, the greater will be the security of supply. In the Director's view, reasonable customer protection measures can be implemented without restricting competition through the delineation of a "core" market or by defining ESCs.

Lambton

10.1.21 Lambton supported the Director's position that competition in the natural gas marketplace is

Ontario's best protection for all parties involved.

Board Staff

10.1.22 Board Staff submitted that an appropriate objective arising from these proceedings would be to provide adequate supply security while maximizing competition in the marketplace. Consequently, a consumer should be able to arrange its own gas supply, without the imposition of onerous protection measures. The customer must assume responsibility for matching an adequate supply with its natural gas requirements.

10.2 Short-Term Supply Arrangements

Diversity

The LDCs

10.2.1 Consumers' supported diversifying gas supply sources in order to mitigate the risk of supply interruption.

10.2.2 Union noted that WGML is a highly reliable supplier due to its diverse sources of supply from extensive contracted reserves. Union suggested that an alternative to a diverse supply portfolio is to contract for dedicated reserves. Union noted that some Ontario direct purchasers rely on contractual guarantees or warranties which, depending on the supplier, may involve significant risk.

The Brokers

10.2.3 ECNG submitted that delivery assurance for short-term contracts requires that the supplier obtain gas supplies from a diversity of sources, and ensure that deliverability is in excess of contractual commitments.

10.2.4 GasPurchase submitted that direct purchase customers generally have access to expert advice concerning reliability of supply through contracting with large producers or brokers who have several sources of supply.

10.2.5 NCM submitted that the contractual process is the best mechanism to ensure supply and deliverability for the term of the contract. NCM agreed that diversity of supply greatly reduces the risk of supply failure.

10.2.6 Ocelot noted that, while diversity is beneficial for the end user, contracting from various production sources for firm supply and transportation can be expensive due to pipeline and producer demand charges.

The Producer Associations

10.2.7 CPA noted that short-term supply arrangements are not rigorously scrutinized by the AERCB to ensure that reserves are adequate. Therefore, the risk of failure of short-term supply is greater than for long-term supplies.

10.2.8 IPAC supported diversity of supply sources to enhance reliability. IPAC argued that, since many Ontario direct purchasers, including GASAMO members, are tied into a limited supply base, their security of supply may be at risk.

OAPPPA

10.2.9 OAPPPA submitted that, since supply currently exceeds demand, diversity of producers' resources may only be of importance in the longer-term.

WGML

10.2.10 WGML submitted that, due to the present market imbalance, direct purchasers are focusing on the price advantage of short-term supplies. WGML argued that supply diversity is of greater importance for the "core" market since a reliable supply of gas is essential to this group.

Board Staff

10.2.11 Board Staff pointed out that, although diversity is available among suppliers, producing areas or pools, TCPL is the only major pipeline serving Ontario. It argued that another means of delivering natural gas from alternative sources to Ontario would improve security of supply to Ontario consumers.

Backstopping

The LDCs

10.2.12 Consumers' noted that it offers backstopping services to its T-service customers and its Alberta Buy/Sell customers. Consumers' submitted, however, that its backstopping arrangements provide only a temporary solution for short-term supply interruption.

10.2.13 Union pointed out that its backstopping services are also a temporary expedient, not a replacement for contracted supply. Union submitted that backstopping involves a cost, and that this cost can and should be reduced by reasonable precautionary measures.

10.2.14 ICG indicated that it would continue to increase storage availability to enhance its backstopping service, which it offers on a "best efforts" basis.

The Brokers

10.2.15 ECNG submitted that direct sellers usually maintain informal backstopping arrangements as an added precaution beyond diversity of sources.

10.2.16 GasPurchase submitted that, if formal or informal backstopping services fail, the Ontario LDCs can usually provide the service on all but design peak days. GasPurchase supported the proposition that the LDCs increase storage capacity and delivery facilities to provide backstopping services to all direct purchase customers.

10.2.17 NCM pointed out that there will always be firm customers who could be interrupted, should supply fail, to provide backstop service for an equivalent economic gain. NCM submitted that a failure of supply will not occur if there is sufficient economic motivation for others to act as alternative suppliers.

10.2.18 Ocelot also supported the LDCs adding incremental storage to increase their backstopping capability. Ocelot submitted that this would provide a relatively inexpensive and efficient underpinning of a direct purchase oriented supply system.

10.2.19 Pan-Alberta submitted that backstopping is not an appropriate alternative to long-term contracts as the ability of a distributor to backstop depends largely on an over-supply situation in the market.

The Producer Associations

10.2.20 CPA submitted that backstopping arrangements are generally provided on a best efforts basis, which does not provide a solid assurance that backstopping gas will be available.

10.2.21 IPAC submitted that, while corporate guarantees may be an appropriate backstopping measure for some customers, such guarantees are not a replacement for gas supply services, and usually only result in the payment of money.

Consumers and Consumer Associations

10.2.22 OAPPPA submitted that supply will exceed demand in the next three years. Prudent purchasers should assure themselves that their contracts have dedicated reserves, and should also make backstopping arrangements with their LDC.

10.2.23 Maple Leaf Mills and Cargill Grain supported the addition of incremental storage, subject to a cost study being submitted to the Board, and the costs being recovered from all firm customers.

Lambton

10.2.24 Lambton submitted that the importance of storage in situations of short-term supply outage ought to be emphasized. Sufficient storage is essential for backstopping services, and is available not only from the LDCs but from Ontario farmers.

Board Staff

10.2.25 Board Staff submitted that backstopping services and storage were both important elements for reliable service. Emergency supplies of natural gas located close to the Ontario market, and needle peaking facilities offered by an LNG plant should be considered as future backstopping alternatives.

Other Concerns

The LDCs

10.2.26 Consumers' submitted that most end users will rely on governments to ensure that gas is available in the longer term, and suggested that short-term supply security would be enhanced if the LDCs maintained adequate facilities for anticipated requirements.

10.2.27 Union submitted that its ability to provide security of supply on its system is limited because it cannot require that interruptible direct purchase customers make their volumes of gas available to Union during periods of interruption. Union urged the Board to reconsider this matter at the earliest opportunity.

10.2.28 ICG submitted that the present surplus of gas will not continue and that there currently is a false confidence in the market. Even with the current surplus, ICG believes that short-term supply may not be deliverable due to limitations in pipeline capacity.

Pan-Alberta

10.2.29 Pan-Alberta submitted that short-term contracts do not provide security of supply, since they do not encourage producers to explore or develop new sources as there is no enduring market commitment. The current predominance of short-term contracts in the direct purchase market has created an attitude of overconfidence that supply will always be abundant.

CPA

10.2.30 CPA claimed that the record clearly indicated that end users have a misguided perception that a short-term contract with an evergreen clause, or a meet-or-release clause, provides long-term security. CPA pointed out that this is not true, and that such arrangements can be terminated by either one of the parties.

IGUA

10.2.31 IGUA submitted that although there appears to be a current surplus of gas, the capacity to deliver this gas is restricted. IGUA submitted that the increasing demand for gas and capacity will balance supply and demand, and contracting practices will adjust accordingly.

WGML

10.2.32 WGML pointed out that producers may not necessarily be willing to recontract with direct purchasers upon expiry of short-term contracts. Just as customers seek the lowest price available, suppliers will seek the highest bidder. For this reason WGML argued that short-term contracts with an evergreen clause are deceptive and should not be considered for ESCs. WGML perceived that the most critical aspect of short-term contracts is the reluctance of producers to develop new reserves on the basis of a short-term contract. It submitted that the same philosophy holds true with respect to building additional pipeline capacity.

Board Staff

10.2.33 Board Staff submitted that there is no threat to short-term security of supply at present since most players are aware of the potential risks and methods to avoid them. Further, the existing surplus minimizes the risk of short-term supply interruptions.

10.2.34 Board Staff submitted that Ontario direct purchase agreements differ from those used in the California market, where short-term contracting practices resulted in a supply failure to SoCal. Board Staff further submitted that it is the terms of the contract which provide security of supply, not the length of time the contract will be in effect.

10.2.35 Board Staff concluded that, since the situation with respect to the gas surplus will change eventually, there should be a further review of supply requirements.

10.3 Long-Term Supply Arrangements

Continental Market/Free Trade

The LDCs

10.3.1 Consumers' indicated that there is a move towards a continental market for gas in North America. Examples of this are the Pan-Alberta contract, and the Union's proposed St. Clair connection to Michigan. While agreeing that the continental market for natural gas is in the process of developing, Consumers' did not expect that it will be operational for several years.

10.3.2 Consumers' argued that with the development and operation of the continental market, aided by the FTA, Ontario customers will be competing directly for gas supply with U.S. end users. Consumers' submitted that if Ontario end users want security of supply, they should be prepared to contract long-term for Alberta gas.

10.3.3 Union submitted that as U.S. markets have increased access to Canadian gas, so Canadian markets should have increased access to U.S. sources. Union noted its recent application to the Board for permission to construct a pipeline connecting it to U.S. supplies and storage. This, Union claimed, will improve Ontario's security of supply and its access to competitive transportation systems.

10.3.4 Both Consumers' and Union pointed to other jurisdictions, particularly California, as support for Ontario protecting its "core" market segment.

The Brokers

10.3.5 ECNG submitted that the implementation of free trade would not jeopardize the security of supply for Ontario, and could well enhance it.

10.3.6 ECNG submitted that the FTA would not curtail the NEB's ability to grant export permits.

Further, in terms of increased U.S. purchases, ECNG noted that a large percentage of current exports are very short-term or spot sales, and do not present a threat to the Canadian public interest.

10.3.7 GasPurchase also foresaw no threat from the FTA, and submitted that, although the power will transfer from the NEB to the Cabinet, the Federal Government will remain the ultimate guarantor that Canadian gas needs will be met.

10.3.8 NCM submitted that the concerns over the FTA can be readily dismissed since limited pipeline capacity to the U.S. restricts exports. NCM agreed that a continental gas market is rapidly emerging, but submitted that, as long as Ontario consumers are willing to pay the market price, gas will always be available to them.

10.3.9 Northridge also submitted that free trade poses no threat to Canada's gas supply. Again, it was claimed that pipeline capacity will always limit the amount of gas which can physically leave Canada. Northridge argued that, while limited, these exports still provide an incentive for ongoing exploration and development by Canadian producers, and that the current Canadian imports of small volumes of U.S. gas are important as an alternative gas supply, and as a means to identify competitive prices.

10.3.10 Pan-Alberta submitted that the FTA does not establish a continental energy market or policy, as the governments of Alberta and Canada retain their control over natural gas reserves. Pan-Alberta submitted that the goal of the FTA is consistent with the deregulation of the natural gas industry, since it increases access to markets in both Canada and the U.S.

The Producer Associations

10.3.11 CPA submitted that the continental market is a longstanding reality which reflects the natural and traditional trade flows between two neighboring countries. The FTA expands upon the General Agreement on Tariffs and Trade (GATT) which also provides for export restrictions for the conservation of non-renewable resources.

10.3.12 IPAC submitted that the continental natural gas market is developing, as indicated by the comprehensive system of pipelines that interconnect the two areas of developed natural gas supply (western Canadian sedimentary basin and the southern U.S.). Provided that Ontario is prepared to remain competitive with other North American markets for natural gas, it can only benefit from the existence of a continental market. IPAC further submitted that the impact of the FTA will be to ensure the continued existence of a viable, market-driven natural gas industry that is able to maintain the long-term development of secure, reliable supplies of natural gas.

OAPPPA

10.3.13 OAPPPA submitted that there is little doubt that a continental market for natural gas is developing, and that U.S. buyers are becoming more interested in securing long-term supplies of Canadian gas. Further, free trade will impact on Canadian reserves proportionately more than it will on U.S. reserves in the event that prorating of existing gas supplies is required.

10.3.14 OAPPPA supported Union's submission that a reserve of natural gas should be set aside for future Canadian needs, and not subject to the FTA. OAPPPA further commended Union's activities related to linking U.S. gas to Ontario users. OAPPPA submitted that the additional diversity this will provide can only benefit the long-term security of natural gas in Ontario and the rest of Canada. Further, an alternate source of supply will also be of assistance in Union's negotiations with WGML.

WGML

10.3.15 WGML submitted that both customers and producers benefit from diversity of supply and markets, and free trade and the emerging continental gas market will provide even greater diversity. Although there are presently many unknown factors, free trade will impact on Ontario's security of supply. Therefore, WGML submitted that steps can and should now be taken to minimize any negative impacts that these factors may have.

The Director

10.3.16 The Director submitted that to characterize the Canadian and U.S. energy markets as a continental market was a gross overstatement. The Director stated that there are many regulatory and legislative differences between the two markets. He further submitted that nothing in the FTA alters the fact that the NEB regulates in the Canadian public interest. Some of the NEB's decision making power regarding export licensing would shift to the Governor-in-Council, but the power itself is preserved.

10.3.17 The Director submitted that the fundamental question in any export application is the ability of Canadian reserves, established and potential, to support both export and domestic demands. The new competitive environment involves issues which are different from those in a regulated environment. The Director argued that the NEB altered its surplus procedure to assess four factors which could impede the market from adequately and fairly meeting Canadian energy requirements in the face of increased foreign demand. These four factors are:

(1) that supply and demand may adjust to price changes, but with some lag allowed for the time it takes to develop new sources of gas or to switch to alternate energy sources;

(2) that in a market oriented energy economy, the level of Canadian gas requirements will vary, depending in part on price levels;

(3) that in any international trade environment, the foreign government's energy policy and regulation are beyond Canada's control and could adversely affect Canadian export volumes or prices; and

(4) that the ability to import gas into Canada is limited.

Board Staff

10.3.18 Board Staff submitted that the FTA serves to further deregulate the natural gas market in Canada. If the legislation is passed bringing the FTA into effect, the NEB may no longer have the power to deny any export licence without triggering the proportionality clauses contained in the FTA. Board Staff argued that, while this is of serious concern to Canada's security of supply, contracting by Ontario customers cannot override the proportionality provisions.

10.3.19 Board Staff noted that there are major pipeline constraints which currently inhibit the growth of exports to the U.S. It indicated that the expected growth in the California market is modest, and that the U.S. still has a large amount of potential reserves. Board Staff therefore concluded that U.S. producers will likely be competitive with Canadian producers and Canadian gas exports will find strong competition when attempting to displace U.S. gas supplies.

Long-Term Contracts in Other Market Areas

The LDCs

10.3.20 As an example of long-term contracts in other market areas, Consumers' cited Pan-Alberta's 24 year contract to export gas to California.

Consumers' submitted that this is an indication that since U.S. distributors are willing to enter into long-term contracts, so should Canadian end-users.

10.3.21 Union argued that in U.S. markets, as well as in other provinces in Canada, plans are being made for long-term security of supply for "core" customers. Union submitted that other market areas are accepting long-term contracts as necessary to provide for security of supply.

The Brokers

10.3.22 GasPurchase submitted that present export levels do not pose a threat to Canadian gas markets, and pointed out that apart from two existing contracts (Pan-Alberta and Alberta & Southern), there are no large new gas export proposals. Canadian producers also face stiff competition in the U.S. market from local suppliers.

10.3.23 Pan-Alberta cited the gas supply criteria that have been established in California for its "core" market and the LDCs. The CPUC has determined that long-term contracts are important for security of supply, especially for the core market. Therefore, SoCal has recently contracted with Pan-Alberta for a 24 year supply. Pan-Alberta then compared the American utility's willingness to contract long term with that of Ontario LDCs, and submitted that the NEB was advising Canadian end users to contract for security of supply if they desired it. Pan-Alberta submitted that the OEB must recognize the need for ESCs to be protected over the long term.

The Producer Associations

10.3.24 CPA submitted that a major factor in assessing the long-term availability of gas supply is the competition from other market areas for those same supplies. CPA identified the main competitors as being U.S. buyers who are interested in committing to long-term contracts. CPA submitted that supply will tighten, and competition for uncontracted reserves will increase.

10.3.25 IPAC indicated that the willingness of other markets, such as California, to enter into long-term contracts provides a message to Ontario to also commit to long-term contracts. IPAC referred to the Pan-Alberta contract with SoCal, and to the Alberta & Southern application for export permits. IPAC further submitted that once those volumes of gas are committed they will no longer be available to the Ontario market.

WGML

10.3.26 WGML submitted that it has the largest, most diverse gas supply in North America, and has the obligation to sell this supply to whatever markets it can. WGML argued that the strength of this supply enables it to sell to markets requiring long-term contracts, and thus attract any price advantage which long-term contracts can obtain. Therefore, WGML submitted that it will go where the market is willing to pay these prices and to contract long term.

The Director

10.3.27 The Director submitted that the U.S. LDCs are still in a monopoly position as merchants of gas in their market areas. Thus, the security of market enjoyed by U.S. LDCs may lead them to offer Canadian producers terms that cannot be matched by Ontario LDCs. The Director argued that this advantage derives from different regulatory practices and does not arise from the operation of competitive forces.

10.3.28 The Director further submitted that although British Columbia and Alberta have restricted access to their core markets, they also control their own gas production and have the jurisdiction to redress the competitive distortions that the core policies cause. Ontario does not have such jurisdiction to redress any distortions caused by a restriction on core market access. The Director submitted that Alberta's approach to the problem is to persuade Ontario to institutionalize the distortions.

Board Staff

10.3.29 Regarding the Pan-Alberta licence extension to export gas to the California market, Board Staff pointed out that this export licence does not increase the amount of natural gas being supplied to the California market, but only extends the term of the long-term licence. The reserves backing up this contract have already been committed to Pan-Alberta and do not reduce the total amount of uncontracted reserves.

10.3.30 Board Staff submitted that pipeline capacity supplying Alberta gas to California has currently reached its limits, and that any increase in capacity will take time to allow for planning and regulatory approval. Board Staff therefore submitted that the export market presents no imminent threat to long-term security of supply.

10.3.31 Board Staff submitted that in other potential U.S. markets for Canadian natural gas, pipelines are also at or near capacity. The major growth market in the U.S. is in the northeast. Evidence suggested that it will take several years before all regulatory approvals and pipelines are in place to send Canadian gas to this market. Board Staff, therefore, submitted that existing export levels are not a threat to consumption in Ontario. Any increase in exports will require increased pipeline capacity and regulatory approvals. Board Staff argued that there is, therefore, ample time for the producing sector to respond to meet any increase in demand.

Supply/Demand Balance and Impact on Uncontracted Reserves

The LDCs

10.3.32 Consumers' submitted that the present oversupply of natural gas in Canada has caused prices to fall, and that this has impacted negatively on gas exploration and development. Consumers' argued that, as the oversupply is depleted, prices will rise and uncontracted reserves will be committed, thereby increasing the profitability of gas exploration. Consumers' further submitted that, as supply and demand come into balance, a steady level of uncontracted reserves will be achieved, thereby providing long-term supplies of natural gas.

10.3.33 Union submitted that, in order for development of new reserves to occur and for customers to obtain security of supply, the producers require a contractual commitment from the marketplace to ensure that exploration and development costs can be recovered.

10.3.34 ICG submitted that WGML will continue to offer the most secure supply of gas until 1994, when the TOPGAS commitments are projected to be fulfilled. Once the TOPGAS commitments are satisfied, TCPL/WGML may not be able to maintain all of its producer support.

10.3.35 ICG argued that the present surplus of gas, which will not continue, is creating a false sense of confidence in the marketplace. Other provinces and markets are prepared to contract for long-term supplies, so the surplus is not expected to last long. ICG further submitted that, relative to the total U.S. demand, the Canadian surplus is small, and cannot satisfy a continental demand.

The Brokers

10.3.36 GasPurchase submitted that when the supply/demand balance changes in the future, a subsequent price increase will occur and act as a signal to customers to lengthen their contract terms. While in today's market the contracts are short-term, the business relationships that are being developed by buyers and sellers are for the long term.

10.3.37 NCM submitted that there is no more security of supply in a long-term contract than there is in a short-term contract. In both cases, the seller of gas matches reserves to the expected annual consumption. In either case, producers receive monthly revenues which are reinvested in exploration. As price increases, producers will realize a greater revenue stream to devote to new reserves. NCM submitted, therefore, that security of supply is a direct function of the price of natural gas.

10.3.38 Northridge submitted that long-term contracts do not enhance security of supply, since they require a premium price for the concept of added security. Again, if the customer is prepared to pay the price, the customer will always be able to access gas. Price redetermination within long-term contracts occur often enough for the price of natural gas to always reflect the current market price plus a premium for the long term. Therefore, Northridge submitted that these contracts have been advocated in this proceeding purely out of producer self-interest.

10.3.39 Pan-Alberta submitted that long-term supply contracts can only protect end users' requirements if they allocate established reserves to a particular contract. The price and rate-of-take provisions negotiated for all market sectors will dictate whether producers will, or will not, be able to continue to explore for, develop and produce new reserves.

The Producer Associations

10.3.40 CPA submitted that, as supply and demand come into balance, the volume of gas available for contracting will be reduced. Therefore, it would be prudent for buyers to contract for long-term supplies while supply is still abundant.

10.3.41 CPA submitted that long-term security of supply for Ontario could be protected by the purchase of a diversified gas supply under long-term contracts.

10.3.42 IPAC argued that the present surplus situation will not exist for long, and supply and demand will fluctuate considerably with market forces. IPAC further noted that some of the presently uncontracted reserves are also unconnected, and may require significant capital expenditures before they become readily available supplies.

The Consumer Associations

10.3.43 IGUA submitted that there appear to be adequate gas reserves in Canada to supply Canadian demands for the reasonably foreseeable future.

Once gas supply and demand are in balance, the market will receive clear and accurate signals which are the key to maintaining reserves and transportation deliverability. IGUA submitted that allowing an open and competitive market to operate without imposed constraints would enhance the long-term security of supply. IGUA further submitted that market signals will stimulate the exploration and development of reserves in a timely fashion, when it is apparent that those reserves will be required to meet market demand.

10.3.44 OAPPPA submitted that it was not convinced that current forecasts of changes in the supply/demand balance will have a measurable impact on uncontracted reserves. Canada is currently in an oversupply condition that is predicted by the NEB to continue into the twenty-first century. OAPPPA submitted that, if this is the case, the question is whether producers will devote sufficient attention to the exploration and development of reserves without the signal of long-term contracts. OAPPPA noted that, conversely, brokers feel that long-term contracts will induce shortages by reducing available uncontracted reserves.

WGML

10.3.45 WGML argued that, although there are presently large uncontracted reserves, one must be aware of their present and future deliverability. WGML submitted that it is unlikely that a producer will expend the necessary funds to provide the needed deliverability without having contracted such reserves.

10.3.46 WGML reiterated that its supply will continue to be the most secure source of gas in the future. Its gas supply contracts are all long term, and the earliest expiry date is in 1994, when the TOPGAS agreement expires. Under TOPGAS, the producers have the option to extend their contracts, and indeed some have already done so. Therefore, whenever long-term gas supply is being considered, the strength of WGML's supply must be examined in light of the relative strength of other supplies then available.

The Director

10.3.47 In the Director's submission, supply and demand will respond to the proper communication of price signals in a competitive market. The Director argued that the future development of reserves depends upon the existence of those reserves, along with a sufficient price and an expectation of demand which would justify their development. In economic terms, there is no necessary connection between a long-term sales contract and the ongoing development of reserves. In the Director's view, therefore, a long-term sales contract is simply an indication of the expectation of demand.

10.3.48 The Director argued that it is ridiculous to suggest that if export demand were reflected in long-term contracts that committed all established reserves extending into the next century, while domestic demand, although not reflected in long-term contracts, was also expected to continue into the next century, then producers would refuse to develop additional reserves to meet the expected but uncontracted demand. The Director submitted that this suggestion only makes sense, in terms of the market power which certain producers and marketers could exercise, if competition were forsaken.

10.3.49 The Director further submitted that the emphasis on dedicated reserves in this hearing was overstated. He argued that diversity of supply is the most significant contribution to uninterrupted delivery of gas in the field, and therefore to security of supply. The dedication of specific reserves to a particular sales contract is limited by the reserves available for such a purpose. Beyond the term of the contract, the buyer must rely on the seller to develop or acquire additional reserves to satisfy the buyer's demand. The development or acquisition of additional gas will depend on producers developing reserves in response to the expected demand. Therefore, the Director submitted that, ultimately, the continuation of supply beyond the original term of long-term contracts will depend on precisely the same principles of supply and demand as apply in a competitive market.

Board Staff

10.3.50 Board Staff submitted that the demand for natural gas in Canada will eventually balance supply. There is currently a price advantage for direct purchase customers contracting short-term, while long-term contracts are of the greatest benefit to producers, since they secure a market and alleviate the downward pressure on prices by reducing the surplus. Board Staff argued that long-term contracts are not necessary as incentives to producers to develop reserves.

10.3.51 Board Staff further submitted that, as the surplus of gas diminishes, the contracting practices of direct purchasers will change in response to increasing prices and decreasing reserves. It argued that when there is no longer a price advantage to short-term contracts, long-term contracts will become more predominant. They will also become necessary to underpin any large facilities expansion.

10.3.52 Board Staff also submitted that long-term contracts provide a certain degree of market stability for end users and producers. It further argued that if the producers can be price competitive, the LDCs will attract direct purchasers back to their systems. However, long-term contracts should not be mandated for direct purchase customers. Board Staff submitted that the Board should assist the market by monitoring direct purchase contracts and publishing aggregate prices, and that the Board should also be given the responsibility to monitor the direct purchase arrangement beyond just the transportation approvals.

10.4 Transportation Capacity

The LDCs

10.4.1 Consumers' submitted that spare and advance capacity on the TCPL system have declined rapidly as the load factor of U.S. customers has increased. The availability of Interruptible Service (IS), Peaking Service (PS) and Temporary Winter Service (TWS) are all now limited. Consumers' submitted that TCPL's system will remain "tight" for the foreseeable future.

10.4.2 Consumers' argued that, while TCPL may be prepared to relax its rule that new facilities will be built only if supported by an executed transportation contract, there is no guarantee that system producers or the NEB will accept this approach.

10.4.3 Consumers' submitted that if Ontario end users are concerned about capacity, the safest route would be to have the LDCs contract with TCPL for increased capacity. TCPL's pipeline capacity is only adequate to serve the Ontario market under normal weather conditions. A particularly cold winter would have impacts ranging from extensive curtailments of the interruptible market to disruption in the flow of gas to the firm market.

10.4.4 Consumers' argued that the competition for pipeline capacity is now quite intense, since the lead time for substantial additions to the transmission system is usually longer than the notice of the swings in the market.

10.4.5 Consumers' submitted that the present administration of the ODV methodology presents a serious threat to the security of supply to Ontario.

10.4.6 Consumers' submitted that the cost of its proposal would be quite modest, and argued that, since all customers benefit from a lower cost of gas, all customers should pay for any underutilized capacity, provided it had been contracted for in a prudent and reasonable fashion.

10.4.7 With regard to renewal and reversion, Consumers' submitted that the pipeline capacity which would become available in these circumstances should revert to the LDC. However, if TCPL's application to build additional advance capacity is accepted by the NEB, some of Consumers' concerns should be alleviated.

10.4.8 Regarding incremental storage capability in Ontario to enhance security of supply, Consumers' submitted that an LNG facility could provide backup needle peaking services that complement seasonal service from underground storage. Consumers' submitted that the Board ought to endorse additional LNG storage as a security of supply measure.

10.4.9 Union submitted that firm service capacity on both the NOVA and TCPL systems is in short supply, and noted there is a queue of shippers seeking access to the TCPL system. The present restrictions on the TCPL system prevent the LDCs from recapturing capacity that is no longer required by direct purchasers.

10.4.10 Union supported Consumers' recommendations concerning the contracting for additional capacity on the TCPL system, and the recovery of incremental capacity costs through rates. Union submitted that in the short term, access to capacity is more important to security of supply than the availability of the commodity itself.

10.4.11 ICG supported the argument that security of supply must be assured by transportation arrangements as well as gas supply. ICG indicated that it would continue to increase its storage, in order to improve security of supply and reduce costs by allowing the utility to take gas at a higher load factor. Further, with additional storage capacity, ICG would also be able to reduce its CD level.

10.4.12 ICG submitted that it will continue to contract for sufficient transportation capacity on the TCPL pipeline to transport gas supplies for its sales service customers. Presently, ICG holds excess capacity under its CD contracts with TCPL, and it does not anticipate any problem in maintaining sufficient transportation capacity on the TCPL pipeline to serve the needs of its current customers.

The Brokers

10.4.13 ECNG submitted that some of the potential problems that result from TCPL's inability to provide sufficient firm service for direct purchase customers and others are being resolved. ECNG supported Consumers' proposal to add stand-by capacity, and submitted that the costs of such capacity should be allocated among those customers that benefit from this feature. ECNG submitted that security would further be enhanced if customers had the right to assign their renewal rights on the TCPL system as well as their capacity within a contract term.

10.4.14 GasPurchase submitted that, with the exception of some short-term problems, transportation capacity is not a fundamental risk to either security of supply or reliability since, with the necessary lead time, transportation facilities can be built as required.

10.4.15 GasPurchase further submitted that the current short-term problem stems from the lack of capacity in the NOVA system, due to WGML's refusal to release any of its unutilized capacity. GasPurchase indicated that the issue of the reversion of capacity in the event a direct purchaser returns to an LDC is currently before the NEB. GasPurchase observed that the general trend in NEB decisions has been to move TCPL to more open access for direct purchase gas.

10.4.16 Ocelot took the same position as GasPurchase, and noted that the majority of direct sales transactions take place under distributor buy/sell contracts, which greatly simplifies the TCPL "return risk".

10.4.17 Pan-Alberta concurred with Board Staff's position that a constraint may occur if the identification of needs for additional capacity is not made in time to get into the planning queue with TCPL. Pan-Alberta argued that, as long as the market is responding to supply/demand signals, these timimg difficulties should be transitional and should not impair overall market development.

10.4.18 Regarding renewal and reversion, Pan-Alberta maintained that Ontario distributors alone should serve ESCs, thereby identifying the market for the distributor and partially defusing the issues of reversion and recontracting.

10.4.19 Pan-Alberta submitted that an LDC may be put into a difficult position when negotiating for long-term supplies if it is unable to identify its market requirements. Pan-Alberta argued that while Consumers' proposal for advance capacity on the TCPL system has merit, Pan-Alberta would oppose a distributor incurring any costs that might ultimately reduce producer netbacks.

The Producer Associations

10.4.20 CPA submitted that most issues related to capacity fall within the jurisdiction of the NEB. CPA claimed that Consumers' proposal to contract for spare capacity is completely unnecessary and CPA viewed it as an unwarranted interference in the competitive market. All the risks that this measure is designed to avoid can be dealt with through prudent contracting.

10.4.21 CPA noted that, since one of the risks assumed by a direct purchaser is that of obtaining and maintaining transportation capacity on TCPL, the consequences of accepting that risk should be borne by the direct purchaser. If the Board is concerned about these risks, contracting standards should be imposed on these customers. Allowing the LDC to hold additional capacity on TCPL, and to pass those costs onto its customers, gives the LDC an unfair advantage in the competition for TCPL capacity. Other shippers do not have the ability to pass off demand charges if the space is not used. Further, the proposal would accelerate the need for additional facilities, and would lead to a cost to all TCPL shippers as these additional facilities are rolled into TCPL's rate base.

10.4.22 IPAC submitted that those customers who are allowed to participate in direct sales ought to be prepared to arrange for and hold their own capacity on each of the involved pipeline systems. Should any party choose to contract for capacity in excess of its current needs, the costs associated with maintaining excess capacity should be borne entirely by that party.

10.4.23 If each Ontario LDC were granted the exclusive right to serve its ESCs, IPAC submitted that it would support Consumers' proposal. IPAC's support would be subject to the level of spare capacity held by the LDCs having been determined as prudent. IPAC argued that spare capacity can only be endorsed in a growing market. In order to avoid the burden of unnecessary additional costs to the LDC's customers, the LDC should sublet any spare capacity on its transportation system.

10.4.24 If the ESCs were supplied by other parties, IPAC submitted that it would then oppose Consumers' proposal that the costs of spare pipeline capacity be borne by the LDCs' customers.

10.4.25 IPAC also submitted that shippers should contract for pipeline capacity to reflect the requirements of their markets. Firm supply contracts should be matched by firm transportation contracts.

Consumers and Consumer Associations

10.4.26 IGUA submitted that capacity constraints will eventually be eliminated so that capacity will be able to match the demand for gas supply. IGUA did not endorse Consumers' proposal, claiming it would limit the range of alternatives available to a gas customer in Ontario seeking to obtain capacity on TCPL's system. IGUA argued that the proposal is inconsistent with the open access principles of a competitive marketplace.

10.4.27 OAPPPA agreed that pipeline capacity on the present transportation systems threatens to constrain supply in the short term. OAPPPA submitted that it saw no merit in committing capacity to LDCs, since TCPL's system capacity is available to all shippers, and TCPL has the responsibility of ensuring that its facilities are adequate to serve foreseeable needs.

10.4.28 OAPPPA submitted that TCPL, rather than the LDCs, should determine who should use its system, and establish priorities in the event that the system should prove inadequate. A direct purchaser's transmission capacity should revert to the LDC upon termination of its direct purchase arrangement.

10.4.29 Maple Leaf Mills and Cargill Grain supported the concept of Consumers' proposal, provided that the cost of any forecast excess capacity over actual demand is allocated uniformly to all classes of customers, and not charged solely against direct purchase customers.

WGML

10.4.30 In response to evidence suggesting that the TCPL system is only adequate under normal weather conditions, WGML maintained that no firm customer was interrupted on the TCPL system last winter. TCPL admitted that the system will have less interruptible capacity than it had in the past.

10.4.31 WGML indicated that TCPL is proposing that the NEB approve building facilities for advance capacity, and submitted that approval would be more likely if it had both producer and distributor support.

The Director

10.4.32 The Director submitted that, although pipeline capacity has traditionally been constructed on the basis of long-term contracts, in a competitive market, some pipeline capacity must be available for short-term and spot arrangements. The Director argued that there is a balance between an appropriate level of flexibility which such capacity would provide, and the waste of resources which an excess of capacity would involve. Mr. Schultz saw this balance as being a matter for those parties prepared to take the financial risk of acquiring capacity, and the regulators who may be called upon to assign the cost of such capacity.

Board Staff

10.4.33 Board Staff submitted that, given the high reliability of the pipeline system, the Board should not concern itself with day to day security issues. With respect to Consumers' proposal, Board Staff submitted that the need for this extra dedicated capacity is uncertain. Any decision concerning additional capacity should be left to an individual rate case for the Board to determine its prudence in terms of the costs and benefits to the end users.

10.4.34 Regarding capacity on the TCPL system, Board Staff submitted that there is some uncertainty as to the ongoing availability of pipeline capacity, and that if advance capacity were sought by TCPL, and allowed by the NEB, there should be no problem due to capacity constraints. On the other hand, if capacity constraints were to occur, they would have only short-term impacts on the consuming market in Ontario.

10.4.35 Board Staff submitted that the issue of reversion rights of pipeline capacity remains an outstanding issue beyond the jurisdiction of this Board.

10.4.36 Board Staff submitted that the Board should continue to monitor pipeline capacity so that it can give whatever advance notice is necessary to expedite the solution of problems as they arise. It submitted that pipeline capacity is not enough of a concern at the present time to warrant mandated long-term contracts for direct purchasers.

Market Segmentation

The LDCs

10.4.37 The LDCs were consistent in their submissions that the market should be segmented, although each gave a slightly different reason. They supported the establishment of the ESC class, which they considered should consist generally of those customers who have no alternate fuel, use gas primarily for space heating, or are public buildings such as hospitals and schools. One LDC was concerned that the ESCs should not be allowed to favour short-term gains at the expense of security of supply. One argued that since the ESCs would not be permitted to be without gas, their poor contracting practices should not be permitted to jeopardize the supplies to others.

10.4.38 Consumers' proposed that end users who depend on natural gas in such a fundamental manner that their requirements would always be a priority should be classified as ESCs. This group would include all residential and commercial customers using gas for space heating, cooking, in apartment buildings and institutions such as hospitals and schools. Potential suppliers to this market should, according to Consumers', be subject to mandatory standards which would require long-term contracts for supplies supported by dedicated or pooled reserves.

10.4.39 ICG supported Consumers' proposal, but would exclude end users with dual fuel capability from the ESC group, and would require ESCs to have firm contracts for pipeline capacity. ICG submitted that the Board might also consider establishing non-mandatory guidelines for non-ESCs.

10.4.40 Union recommended that the ESC group should include residential, institutional and commercial users of natural gas. Union argued that an end user should not be automatically excluded from the ESC group because it had dual fuel capability. If the ability to switch is limited to providing only temporary relief, Union maintained that the end user should still be considered an ESC.

The Brokers

10.4.41 NCM, Northridge, Ocelot, and GasPurchase all submitted that there was no need or rationale for segmenting the market. They supported a competitive market in which all customers and suppliers can contract freely.

10.4.42 Ocelot considered that the Ontario Government should disseminate information, and that customers should be free to make their own choices, conditional only on their knowing of the risks and rewards in a competitive North American energy marketplace.

10.4.43 Pan-Alberta urged that the market should be segmented into those gas users who could reasonably expect government intervention to ensure gas supplies in times of shortage, and those who could not. It encouraged the Board to look to other jurisdictions for guidance, but acknowledged that the Board is in the best position to decide which customers should be in the ESC group and which should not.

10.4.44 Pan-Alberta was the only broker to support segmentation, and it classified residential, small commercial and institutional end users as ESCs. It submitted that the ESCs should have ten to fifteen year rolling average contracts supported by dedicated reserves.

10.4.45 GasPurchase claimed that very small residential or commercial customers would be unlikely to enter into direct purchase agreements since such contracts would be uneconomic below a certain volume.

The Producer Associations

10.4.46 CPA and IPAC submitted that the market should be segmented because, in the absence of prudent contracting, gas supply to the ESCs would be protected by government or regulatory action in the face of a short-term or long-term supply disruption. As a result, the incentive for these customers to contract for security would be non-existent. It was claimed that if this customer group's supply did fail, it would probably be somebody else's prudently contracted long-term gas that would be diverted to meet the needs of this market segment.

10.4.47 Both producer associations submitted that the ESCs should be required to have 10 to 15 year rolling average contracts, backed by a secure diversified pool of dedicated reserves, and the necessary firm transportation arrangements.

IPAC added backstopping arrangements as a requirement, whether through separate contracts or corporate guarantees.

10.4.48 CPA proposed that all residential and commercial customers would be considered ESCs unless they had a sustainable dual fuel capability, and guaranteed access to an ongoing alternative energy source with less than 24 hours notice. IPAC supported CPA's position, adding government, social and educational users to the ESC group.

10.4.49 CPA proposed that by October 1, 1988, the LDC's current customers declare their intention to purchase directly, or thereafter be locked-in as LDC sales customers for a period of 10 years. CPA's proposal would further require that ESC customers that wished to purchase directly would only be allowed to do so if they could demonstrate that their direct purchase supplies would have the same contract term and security as was held by the LDC. CPA acknowledged that its proposal would effectively entrench the market dominance of TCPL and its system producers for 10 years, and beyond.

Consumers and Consumer Associations

10.4.50 Both IGUA and OAPPPA submitted that there is no need for segmentation of the natural gas marketplace. OAPPPA submitted that if the Board were to define an ESC group, then any end user with dual fuel capability should not be included.

10.4.51 Nitrochem and CIL opposed classifying industrial users as ESCs and subjecting them to mandated contractual standards. They stated that industrial gas users who buy direct are sophisticated, and that ensuring future sources of supply was a part of responsible corporate planning.

10.4.52 Maple Leaf Mills and Cargill Grain supported the need for segmentation. Their rationale was that an industrial user could be cut off to supply an ESC, even if the ESC had contracted imprudently. They further stated that the Board should adopt strict standards for ESCs, even if only to protect them against themselves.

WGML

10.4.53 WGML proposed that residential, commercial and other customers who choose to be included as ESCs should have fifteen year contracts with dedicated reserves.

10.4.54 WGML recommended that the Board should consider the reasoning of regulatory authorities in other provinces and California regarding market segmentation. The approach of the NEB to the gas export test has changed, and the Government of Ontario should "pick up its responsibility" and establish an ESC class because a shortage of gas to this market segment, or even the perception of a possible shortage, should be avoided at all reasonable costs.

The Director

10.4.55 The Director submitted that there should be no market segmentation, because it necessarily leads to price discrimination. Mr. Schultz argued that the market segmentation measures being pursued would restrict the choices of "core" customers while leaving producers free to choose the markets they wish to serve. Therefore, any delineation of a "core" market would enable producers to price discriminate against this segment.

10.4.56 He noted that some participants stressed the need for a stable market for producers to develop reserves which would be in the customers' interest. In return for a stable market, those producers offer security of supply. He suggested that, if there were any validity in the argument, it would apply to all customers, not just the "core" market.

10.4.57 The Director also stated that segmentation is unnecessary, since an adequate supply of natural gas to Ontario is of equal concern to all who require natural gas, whether it be for space heating, or process, or other uses. Mr. Schultz argued that the possibility of government intervention in the case of a short-term supply failure has no bearing on whether that supply was under long-term or short-term contracts.

10.4.58 As to the statement that long-term contracts provide price stability, the Director also submitted that the price of natural gas will rise as supply and demand come into balance. Therefore, "...long-term contracts will not shield Ontario consumers from price increases. Nor should consumers be shielded from the price increases necessary to develop additional supply."

10.4.59 Since the Director opposed any market segmentation, he did not define which customers might be considered ESCs.

Board Staff

10.4.60 Board Staff argued that the Government of Ontario cannot take the risk that supply failures will not occur for private and public residential customers, and that this group needs special protection.

10.4.61 Board Staff submitted that those customers who use natural gas for private and public residential use should be separated, unless they have dual fuel capability extending beyond a short-term interruption. Public residential users include hospitals, nursing homes, schools and other institutions.

10.4.62 Board Staff argued that there are two reasons this group needs protection is twofold. The first is the nature of the end-user itself, and the second is the varying degree of sophistication and knowledge that any customer in this group may have that would ensure prudent contracting to secure reliable supplies.

10.4.63 Board Staff held that knowledge is important, and the Board or some other government body should ensure that all potential direct purchasers have access to market information.

10.4.64 All should be free to buy direct, argued Board Staff, but criteria should be established to assure security of supply for those who enter into direct purchase agreements.

10.5 Security of Supply Measures

Short-Term Supply Security

The LDCs

10.5.1 Consumers' labelled long-term contracts as the "flywheel" of the industry, claiming that they maintain stability and tend to smooth the cycles of surplus or shortage, thereby tending to minimize price changes.

10.5.2 Union submitted that in the absence of a mandated surplus, or other Federal Government assurances of long-term supply for Ontario, long-term security of supply is best assured by long-term contracts supported by a diversity of supply sources, including access to American sources. Union argued that short-term contracts do not lead to the development of reserves, as the term of a contract is related to the period required to amortize the costs of the work and the facilities required to service the contract. Union claimed, however, that access to pipeline capacity is more important to security of supply than the availability of the commodity itself.

10.5.3 Consumers', Union and ICG all indicated that they intend to adopt a portfolio of short, medium and long-term contracts for gas supply with dedicated reserves, either pooled or specific, and to ensure continuing deliverability by monitoring.

The Brokers

10.5.4 Northridge, NCM, and ECNG submitted that long-term contracts do not result in secure gas supplies, but lead to higher prices. They argued that, in an efficient market, prices will vary freely with demand and will determine supply.

10.5.5 ECNG considered that long-term contracts do not offer price stability, and that security of supply can best be assured by permitting the largest possible number of sellers and buyers to enter into contracts without government intervention.

10.5.6 GasPurchase noted that there is no persuasive evidence that producers react primarily to contract term, in deciding when to bring on new gas supplies. GasPurchase argued that the more persuasive evidence supported price as the determinant of supply.

10.5.7 Ocelot contended that, if the supply/demand balance changes from the current surplus position, price will increase, and this will signal customers to begin lengthening their contract terms.

10.5.8 Pan-Alberta submitted that, unless reserves are contractually committed to the long-term requirements of Ontario, they will likely be sold to other parts of Canada or to the U.S.

The Producer Associations

10.5.9 Both CPA and IPAC recognized that short-term contracts have a place in the market, but claimed that long-term contracts are the fundamental foundation for development of reserves and stability for end users. Long-term contracts are necessary to support the massive investment required for the development of reserves, gathering systems and processing facilities.

OAPPPA

10.5.10 OAPPPA submitted that there is no short-term security of supply problem. No problem is foreseen in the long-term, until there is a shortage of supply for Ontario. OAPPPA would prefer that its own future supply be secured by long-term contracts, but it would require assurance that prices would not increase at a faster rate than the total operating costs of the Universities.

WGML

10.5.11 WGML submitted that long-term security must be provided to certain market segments, and in view of all of the uncertainties facing the market, only long-term contracts can ensure security of supply. Without such contracts, future reserves may not be located and attached, existing deliverability may not be maintained, and adequate transportation facilities may not be constructed.

The Director

10.5.12 The Director stated that there is "no magic to long-term contracts". The existence of the demand for natural gas is the economic incentive for the development of supply, with price acting as the allocator of supply.

Board Staff

10.5.13 Board Staff considered that guidelines should be developed to provide some protection for those customers that need protection, namely the private and public residential market.

10.5.14 Board Staff regarded the present gas surplus to be such that there is no need to implement short-term security of supply measures. When the surplus diminishes, Board Staff saw a need to reexamine this issue and suggested that the Board recommend periodic reviews, perhaps annually, at the discretion of the Board.

10.5.15 Board Staff submitted that the imposition of a requirement that supply for a market segment must be through long-term contracts would, in effect, reregulate that segment of the market. In order to avoid interfering with the functioning of the market, strict guidelines should not be imposed unless the threat of an imminent shortfall in the supply of natural gas makes it absolutely necessary. Board Staff also considered that long-term contracts serve to accelerate the move to a shortage of gas. It claimed that the evidence was clear that long-term contracts are not necessary to ensure the exploration and development of reserves.

Contract Terms and Conditions

The LDCs

10.5.16 Consumers' and ICG proposed that the ESCs, either purchasing direct or from an LDC, should be served from a contract or a portfolio of contracts with an average life of at least 10 years. These contracts should be supported by dedicated or pooled reserves.

10.5.17 Union submitted that the ESCs should be permitted to purchase direct, provided the contract for supply was on a three year rolling term so that two years of supply would be under contract at all times. This would provide the LDCs with two years lead time to make the necessary supply and transportation arrangements to guarantee service for recontracting ESCs who wish to return to Union's system. Union also urged that the firms or individuals who supply or advise Ontario customers on their supply arrangements be licensed.

10.5.18 All three LDCs submitted that reserve and deliverability assessments should be conducted. ICG and Consumers' suggested that these assessments be filed with the Board for approval.

The Brokers

10.5.19 NCM, GasPurchase, Ocelot, and ECNG submitted that there should be no regulated contract length imposed on any end user.

10.5.20 GasPurchase and Ocelot recommended that the physical and contractual status of contracted reserves should be verified, noting that the contract is only as good as the particular reserves it represents.

10.5.21 ECNG stated that, while dedicated reserves may be appropriate in some cases, a mandated reserve dedication for all contracts may only serve to increase the price being paid for gas, without increasing the supply base.

10.5.22 Northridge proposed that customers of the LDCs be subject to four year rolling contracts with the LDC, but any customer who chooses to go direct should not have standards imposed.

10.5.23 Pan-Alberta proposed that those gas users who could reasonably expect government intervention to ensure gas supplies in times of shortage should be required to have 10 to 15 year rolling average contracts, linked to dedicated reserves. Pan-Alberta recommended that the purchaser reserve the right to monitor deliverability and hence the reserves.

The Producer Associations

10.5.24 CPA and IPAC suggested that ESCs be subject to 10 to 15 year rolling average contracts, and that the contracts be reserve-based and capable of sustained deliverability, or supported by a corporate guarantee.

Consumers and Consumer Associations

10.5.25 OAPPPA supported three year rolling contracts for residential and commercial customers without dual fuel capabilities, in order that they can provide the LDCs with sufficient notice to recontract. In today's market, however, six months would be sufficient. These contracts should be supported by dedicated reserves from a pool or pools, backed by a producer warranty to indemnify the purchaser for any costs incurred if the supply failed.

10.5.26 IGUA did not support imposing any guidelines to secure supplies. It stated that the veiled threat is that, without mandatory gas buying guidelines, Canadian producers will sell all the available gas to customers in the U.S.

IGUA refers to this as the "spook" theory regarding a gas shortage.

10.5.27 Maple Leaf Mills and Cargill Grain supported Consumers' proposition with respect to ESCs. They maintained that ESCs should be served by long-term contracts supported by dedicated or guaranteed gas reserves.

WGML

10.5.28 WGML proposed that residential, commercial and other customers who choose to be included in the ESC group should be served under 15 year contracts, with reliable dedicated gas reserves monitored regularly. WGML noted that, although the ERCB conducts reserve assessments before an Alberta long-term removal permit is issued, the customer is responsible for assuring deliverability.

The Director

10.5.29 The Director opposed the imposition of contracting standards on end users, and added that contracts supported by dedicated reserves would be inconsistent with a competitive market. Imposing these restrictions would also restrict the flexibility of producers in developing and producing reserves in the most economic fashion.

Board Staff

10.5.30 Board Staff recommended three year rolling contracts supported by a pool of proven reserves for the public and private residential gas users. Reserve and deliverability assessments should be undertaken for the private and public residential customers, by a reputable engineer, and filed with the Board for each contract.

Market Access and Obligation to Supply

The LDCs

10.5.31 Consumers', ICG, and Union supported broad market access and competition for service. The ESCs should be free to contract with the suppliers of their choice, provided that such suppliers are able to meet the standards established for contracts with that group.

10.5.32 With regard to the obligation to supply, all three LDCs state that an end user wishing to return to the LDC as a sales customer should be served on a best efforts basis. Each believed that such a customer could be accommodated if adequate notice of intention to recontract was provided. Consumers' submitted that in today's market this would be a few months, but a longer notice period could be necessary several years from now. Union and ICG considered that the adequate lead time would be two and three years respectively.

10.5.33 Union added that a true obligation to supply can only be imposed effectively if there is also a right to supply. Otherwise, significant costs could be incurred without any assurance that they would be recovered from the potential beneficiaries.

10.5.34 Consumers' submitted that, if incremental gas is purchased to supply a returning direct purchaser at a cost higher than WACOG, the returning customer should be charged those costs for at least one year. Union did not believe that it is feasible, in advance, to precisely define how to recover costs that may be involved with recontracting. ICG proposed that the costs should be passed on directly to the customer until the next rate case. At that time, it would be determined whether or not the additional cost should be rolled in as part of the WACOG.

The Brokers

10.5.35 Northridge argued that the LDCs' sole responsibility to supply is with respect to those customers who choose to stay on their systems, but that the LDCs have no obligation to serve those customers who wish to recontract. NCM recommended that the LDCs be obligated to recontract, but that returning customers be treated no differently than new customers. GasPurchase and Ocelot stated that a customer should be able to return to the distributor with 3 to 6 months notice, and should be charged any demonstrable costs incurred as a result.

IPAC

10.5.36 IPAC agreed that there should be competition for service, but if the LDCs were given the exclusive right to supply gas to the ESCs, then they must also be obligated to serve that market. If no right to serve was given to the LDCs, then the obligation to serve would be on a best efforts basis, and any additional costs incurred should be borne by the recontracting customer until the date of the first price redetermination of WACOG.

Consumers and Consumer Associations

10.5.37 CIL and Nitrochem each submitted that there should be no difference in treatment between a new and a recontracting customer with respect to service and costs. Each expressed the hope that regulatory authorities will facilitate the assignment of transportation capacity by the direct purchaser. If this is the case, then any special fees or notice requirements with respect to the acquisition of transportation capacity would not be needed.

10.5.38 The OAPPPA supported full competition in the marketplace. It submitted that the LDCs are obliged to deliver, but that any significant costs incurred in the process should be approved by the Board, before the party causing them is charged.

10.5.39 Maple Leaf Mills and Cargill Grain submitted that a re-entry notice of 21 months to the LDCs would be excessive, as it would be highly unlikely that a customer would be in a position to decide on re-entry so far in advance of the end of its contract. It added that a re-entry charge runs counter to a fundamental principle of utility rate making in that all customers in a class should be charged the same rate, even if they are a new or a recontracting customer.

The Director

10.5.40 The Director supported free market access and full competition. New and recontracting customers should be treated the same, and no marketer has a greater obligation than any other marketer to serve gas to any end user.

Board Staff

10.5.41 Board Staff supported full competition in servicing customers who have standards imposed on their supply contracts. Board Staff submitted that alternate supplies, equally as secure as those from WGML, are available to customers in Ontario.

10.5.42 Board Staff stated that the LDCs should be obliged to serve a recontracting customer on a best efforts basis, as it would a new customer, if proper notice is provided. The LDC ought not have any obligation to supply within a proper notice period of two years, as the LDC would not have sufficient time to make the necessary capacity and gas supply arrangements. Any costs to the system should be dealt with on a cost causality basis.

10.6 Market Impact From Security of Supply Measures

Relative Price Among Groups

The LDCs

10.6.1 Consumers' submitted that once the ESCs have access to multiple suppliers, the marketplace will quickly determine the "cost of supply security". It claimed that at present there is a premium paid for long-term supply, but the differential would likely be reduced or disappear completely when the supply surplus is diminished. Non-ESCs, by contrast, will continue to "enjoy the benefits of deregulation and associated market responsive prices". Consumers' stated that some increased costs may result for all customers if Consumers' capacity recommendations are adopted.

10.6.2 Union argued that the standards suggested for the ESCs would limit their ability to purchase spot gas, which is presently priced lower than longer-term contract gas. Union noted that spot prices are highly volatile but claimed that, over the long term, the average cost of purchasing gas under spot and long-term contracts will roughly be equal.

10.6.3 ICG submitted that if only one portfolio of purchases is permitted, the additional cost of obtaining the security of long-term supplies will be spread equally over the commodity cost to all of the LDCs' customer classes. This will result in the LDCs offering a non-competitive price to the non-ESCs compared to the cost of short-term and spot gas. ICG recommended that it be permitted to develop two portfolios of gas supplies, with two WACOGs, in order to reflect the differences in load factors and the costs of secure supplies for each group.

The Brokers

10.6.4 NCM submitted that relative price stability would be ensured through its proposal for a free and competitive marketplace.

10.6.5 Ocelot, GasPurchase and Northridge argued that imposing standards would increase prices, whereas in a competitive free market, prices will respond properly to supply and demand at the market level.

The Producer Associations

10.6.6 IPAC submitted that the natural gas price for the ESCs and other gas users in Ontario will result from negotiated contracts which would reflect the market conditions at that time.

10.6.7 CPA claimed that over the short run, given the existing surplus of gas, there will be a slight premium for long-term supplies over short-term gas. CPA argued that the differential, however, would not be due to the mandatory contractual practices recommended by the CPA, but would result from the ESCs paying for security of supply through long-term contracts. CPA also considered that the average price paid under long-term contracts will likely be equivalent to the average cost of spot gas over time.

The Consumer Associations

10.6.8 OAPPPA submitted that the current higher price of system gas over direct purchase gas is sufficient to cause end users to reconsider the need for the absolute security available from the LDCs.

10.6.9 IGUA argued that imposing mandated contracting standards for ESCs will operate as a price "prop" to the advantage of the gas producing interests.

WGML

10.6.10 WGML noted that industrial customers that do not purchase under the contracting guidelines established for the ESCs will likely pay a lower price for their gas. WGML argued, however, that the ESCs will have the related firm, long-term transportation arrangements needed to complement gas commodity contracts. WGML considered this to be an advantage, especially where new facilities are required.

Board Staff

10.6.11 In Board Staff's view, there will be different costs of gas for the three different customer groups. The first group represents the customers served by the LDCs. The other two groups will be within those that purchase direct, those with standards imposed and those that are exempt from standards. The gas cost differentials are not objectionable because they are related to cost, and are not the result of streaming.

Competition Among Suppliers and Market Access

The LDCs

10.6.12 Consumers' submitted that competition among suppliers and broad market access should always be encouraged, and that this will be achieved once the constraints of the old "pre-Agreement" TCPL contracts are removed.

10.6.13 Union stated that there is no evidence to suggest that the standards they have proposed will in any way limit the number of producers of natural gas, or their ability to deliver to Ontario markets. Union argued that the measures they have proposed would not be "unduly onerous" for the responsible purchasers who, in due course, would likely voluntarily adopt similar practices for their own protection.

10.6.14 ICG proposed that ESCs could choose to obtain their gas directly, if established standards were met. ICG claimed, however, that in a competitive market without the constraint of the current TCPL contracts, the LDCs, because of their size and expertise, will be in the best position to act as buyers on behalf of all ESCs.

The Brokers

10.6.15 Pan-Alberta submitted that the number of pipelines serving a region is not a meaningful measure of competition. Provided that a pipeline has open access, then competition can take place.

10.6.16 Northridge, NCM, Ocelot, and GasPurchase submitted that if recommendations for a free, open market were adopted, full competition would exist in the marketplace.

10.6.17 ECNG argued that any significant restriction in the number of buyers in the market can only lead to continued market dominance by the "cartel-like behaviour" of one group of producers.

The Producer Associations

10.6.18 IPAC and CPA submitted that, regardless of the restrictions placed on service to the ESCs, the same suppliers are competing for the same market, regardless of how many parties have access to that market.

10.6.19 CPA claimed that any reduction in the number of sellers capable of servicing the indirect market would be minimal, and there would be no measurable impact on access to, and competition among, suppliers.

The Consumer Associations

10.6.20 OAPPPA claimed that competition among suppliers is available only to those who are able to negotiate directly with producers for their short, medium or long-term needs. The OAPPPA believed that Alberta's "core" policy particularly constrains the commercial and institutional gas users in their ability to access a free market and to select the producer best able to meet their requirements. As a result, they must rely upon Saskatchewan producers.

10.6.21 IGUA proposed that full competition should be encouraged in the market. Action to impose restrictions ought not to be taken until there is some cogent evidence that the market is not working satisfactorily to preserve and enhance the security of supply. IGUA urged the removal of any remaining impediments to open access in order to obtain as many delivery service alternatives as possible.

WGML

10.6.22 WGML submitted that competition for the ESCs would only be limited by existing contractual commitments, and by the inability of some suppliers to assure the security of their supplies. The recommended role of the LDC, as the sole supplier to the ESCs, would not lessen competition among suppliers, since the LDC would seek the most competitively priced gas.

The Director

10.6.23 The Director favoured non-restrictive market access and the fullest competition consistent with the technical operation of pipeline and distribution systems.

Board Staff

10.6.24 Board Staff's proposal for security of supply would result in all end users in Ontario being free to be served by the LDC or by direct purchase contracts. This would provide for the greatest number of buyers and sellers.

10.7 Arbitration Provisions

The LDCs

10.7.1 Consumers' asserted that no one would expect either the supplier or the distributor to contract long-term at prices fixed for the entire term of the contract and that, in the event that agreement cannot be reached through price renegotiations, there must be a formula for setting the price. Consumers' pointed out that, otherwise, the contracts would not be long-term supply contracts at all, and would be rescinded when a price renegotiation failed. According to Consumers', arbitration is probably the only method of dealing with this situation and to ensure that the contracts remain long-term.

10.7.2 Consumers' argued that the determination of the price vis-a-vis the supplier and the distributor is not the responsibility of the Board, and that the Board should have no involvement in the renegotiation or arbitration process.

10.7.3 Consumers' argued that the Board's role arises in the rate case context when it is being asked to accept the gas costs flowing from the gas supply contracts. Consumers' submitted that the distributor's obligation would be to satisfy the Board that the contracts and prices at which gas was purchased were reasonable, given the realities existing in the market at the time of the contract or renegotiation, and given the realities of the arbitration process at that time, considering the evidence then available as to price.

10.7.4 Consumers' requested that the Board acknowledge that the arbitration process itself is a recognized mechanism for resolving price disputes if renegotiation fails.

10.7.5 Consumers' submitted that it would favour commercial, binding arbitration with the guidelines being negotiated as part of the supply contract. According to Consumers', the arbitration clause should provide directives for the arbitrator to follow in arriving at a fair price of gas, and the matters to consider may include:

- prices of substitutable energy sources competing with natural gas;
- prices of gas delivered into the same market under similar terms;
- current Alberta, Saskatchewan and British Columbia border prices under other gas contracts; and
- the current U.S. market prices for similar supply arrangements.

10.7.6 Consumers' took the position that the Board would not be bound by any arbitration award, but would continue to set just and reasonable rates on the basis of all of the evidence tendered in any particular rate case.

10.7.7 Union submitted that the utility should have a high degree of assurance that it can undertake longer-term commitments on the basis that those commitments will be accepted by the regulator, so long as they are prudent when made. Union argued that, to the extent that such commitments involve mechanisms for future price adjustments, there should also be an understanding between the utility and the regulator, at the outset, as to what are acceptable adjustment mechanisms. In Union's view, negotiation, with recourse if necessary to arbitration, is the best method of arriving at a fair price for longer-term supply.

10.7.8 Union submitted that arbitration clauses should provide sufficient direction to the arbiter to ensure that the price determined reflects current market conditions. According to Union, the directions could be very detailed and include criteria that might otherwise form the basis of several indices, or such clauses could simply state that the price payable will be the current available market price for gas under substantially similar terms and conditions.

10.7.9 Union submitted that indexing, while giving the appearance of objectivity, in reality fails to account for all relevant factors that should determine the price, and fails to establish the weight that should be given to such factors when circumstances change. Union submitted that it was better to make the factors that might be used to determine an index the reference points for negotiations and arbitration.

10.7.10 Union argued that, while no government can commit future governments or even itself indefinitely, legislation endorsing prices arrived at by arbitration would be sufficient assurance for the parties directly involved to proceed, with the confidence that the results of arbitration will not be subsequently disallowed by government.

10.7.11 According to Union, if the arbitration process is judged to be reasonable, then the result of that process should also be accepted as reasonable.

10.7.12 Union submitted that the Board could have a greater level of confidence in the results of an arbitration if the Board participated in, or were able to approve the appointment of the arbitrator selected to represent the utility.

10.7.13 ICG argued that, if the Board is satisfied that an arbitration clause is reasonable and provides that the arbitrator or arbitrators take into account appropriate criteria in determining the price, the Board should be prepared to accept the arbitrated price as reasonable. ICG submitted that the Board could reserve the right to reject the arbitrated price, but the consequence of doing so would likely be to frustrate the gas supply contract, or provide grounds for contract termination and immediate surrender of the originally dedicated reserves with a consequent financial penalty to the LDC and its customers. ICG submitted that such a provision will also probably create similar problems for producers.

10.7.14 According to ICG, if the Board reserves the right to reject an arbitrated price, Alberta, WGML, or the producers will then probably demand a similar right of rejection. ICG submitted that the Ontario Government and the Board should accept that an arbitration provision which has been approved by the Board is an appropriate mechanism for determining price, and that further approval of the arbitrated price itself will not be required.

The Brokers

10.7.15 ECNG advocated consideration of Mr. Minion's testimony that arbitration provisions tend to increase prices from the level which they would be if determined solely by the market.

10.7.16 ECNG submitted that an alternative to arbitration is formula based price redetermination provisions. However, in ECNG's submission, the longest reasonable timeframe for the operation of a formula, without renegotiation, would be approximately five years.

10.7.17 GasPurchase and Ocelot submitted that many producers and consumers who are parties to direct purchase arrangements try to avoid arbitration provisions because of the complexity and cost to develop the clauses and to utilize the procedure.

10.7.18 Ocelot submitted that, when arbitration provisions are necessary, it has generally agreed to set out parameters for the arbitrators wherein the winner takes 100 percent of the benefits including payment of its legal and consulting fees. Ocelot submitted that the potential costs of this form of arbitration would generally prohibit the parties from ever using the provision.

10.7.19 Pan-Alberta submitted that where there is no automatic price re-determination mechanism established by the contract, an arbitration clause setting out the criteria upon which prices are to be re-determined from time to time becomes an integral part of a long-term contract.

10.7.20 According to Pan-Alberta, the arbitration clause will generally contain a list of criteria that the arbitrators are to consider in arriving at a price, which the Board, when it first reviews the contracts of a distributor or supplier to an ESC, will no doubt wish to review. Pan-Alberta submitted that the Board must be cognizant of the competing interests of the purchasers and sellers and satisfy itself that the method for appointing arbitrators, and the factors to be considered in the arbitration, are fair and reasonable.

10.7.21 Pan-Alberta submitted that it is not a viable suggestion that a member of a regulatory board or its staff, in either the consuming or producing province, be an arbitrator in a commercial arbitration.

10.7.22 Pan-Alberta submitted that, once regulatory bodies have reviewed and accepted the terms of the contract, including the arbitration provision, and determined that they contain reasonable criteria for price re-determination, they should not interfere with the arbitrated price award other than in very exceptional circumstances. According to Pan-Alberta, any contemplated intervention by a regulatory board in commercially negotiated contracts must be tempered by an appreciation that such an intervention will likely have serious and deleterious effects throughout the industry.

The Producer Associations

10.7.23 CPA submitted that price redetermination and arbitration provisions are required to ensure that the price in long-term contracts reflects the market over the term of the contract.

10.7.24 According to CPA, the contents of the arbitration clause, and how the arbitration will be conducted, are matters for negotiation between the contracting parties who will design an arbitration clause to suit their individual needs.

10.7.25 CPA pointed out that the difficulty arises with respect to the degree to which the arbitrator's decision should be binding upon those who bear the responsibility for protecting the public interest or setting just and reasonable rates.

10.7.26 CPA submitted that it is unrealistic to expect that a decision of a commercial arbitration panel or a single arbitrator should be binding upon the regulatory authorities.

10.7.27 CPA pointed out that the existence of another level of review, after an arbitration has taken place, obviously creates uncertainty for the contracting parties. However, according to CPA, much of the uncertainty could be eliminated, in a practical sense, if the regulatory authorities were prepared to adopt a policy that only in the most unusual circumstances would an arbitrated price be interfered with or deemed imprudent.

10.7.28 In CPA's view, only when an arbitrated price is clearly inconsistent with prevailing market conditions should any regulatory interference be necessary.

10.7.29 The CPA recommended that the Board not adopt the practice of publishing price information for the following reasons:

- It should not be necessary for the Board to publish pricing information. A competitive market will foster its own means of monitoring prices and supply alternatives. Therefore, it is not necessary for the OEB to perform this function.

- In order to protect the competitive position of the parties providing the information, the Board must publish only aggregated pricing data. Such aggregated information would be virtually useless to both buyers and sellers.

10.7.30 IPAC acknowledged that the drafting of an arbitration clause acceptable to both parties may be difficult, and that the resulting arbitration clause may be complex in its application. IPAC noted that an arbitration clause is relied on by the parties to a contract only as a last resort.

10.7.31 IPAC submitted that once the parties to a gas contract to serve an essential service group have reached agreement on all terms, the contract should be submitted to the Board for approval. In IPAC's view, if the Board is satisfied that the agreement, which would include price redetermination provisions, meets the conditions for contracts to the essential service group, the contract would be approved. According to IPAC, there would be no further need for this Board to review this particular contract or the prices resulting therefrom.

10.7.32 IPAC submitted that the prices which arise from freely negotiated contracts, which have been accepted by this Board as meeting security of supply standards, ought not to be further regulated by the Board.

10.7.33 In IPAC's submission, the Board would retain its jurisdiction to ensure that just and reasonable transportation tolls are set for the transportation of natural gas through the systems of the Ontario LDCs.

The Consumer Associations

10.7.34 IGUA viewed mandated arbitration provisions as undesirable in gas supply relationships. It argued that the arbitration provision need not be an essential element of the contract, and if included, should vary depending upon market conditions. IGUA, therefore, submitted that buyers and sellers should be permitted to select the arbitration provision that is most appropriate to their particular circumstances.

10.7.35 OAPPPA submitted that the Universities would be reluctant to accept a long-term contract with future prices determined by binding arbitration. According to OAPPPA, to do so would preclude them from turning to their alternate sources of energy should the arbitrated price exceed the cost of the alternative.

10.7.36 OAPPPA submitted that it would be acceptable to provide for commercial arbitration should the parties be unable to agree, but that either party should be free to reject the arbitration decision.

10.7.37 OAPPPA suggested that, if the Board were to accept the suggestion that gas purchase contracts be filed and updated prices be published on a regular basis, such publications might form the basis for a suitable index.

WGML

10.7.38 WGML submitted that, while most price redeterminations will be achieved through negotiations, the contingency of establishing a price must be provided if the contracting parties fail to agree. Otherwise, the certainty of either market or supply will be lost.

10.7.39 WGML argued that the arbitration provisions agreed to by the contracting parties will provide the legal certainty that price will be reestablished from time to time as required, thereby ensuring that the contract will continue through its entire term.

10.7.40 WGML recommended a process of commercial arbitration whereby the method, conditions and criteria of arbitration would be contractually agreed to by the buyer and seller. Provincial regulatory authorities would review the arbitration provisions at the outset to ensure that those provisions would generate a "just and reasonable price" under the contracts.

10.7.41 According to WGML, before either the buyer or seller would agree to be bound by the result of arbitration, they would have to know that the arbitrated price would not be subject to direct or indirect government or regulatory review which could effectively invalidate the arbitrated result. WGML expressed the hope that governments and regulatory authorities will take the steps necessary to establish an effective contractual arbitration process and thereby support the principles of deregulation.

The Director

10.7.42 The Director submitted that there is no generic inconsistency between arbitration and competition. Competition makes the arbitration task easier since the arbitrator has a reference point when determining what is a reasonable price. This principle would not apply in the case of the core market or in private, commercial arbitrations of gas prices, since there would be no competitive prices to reference.

10.7.43 The Director submitted that the intent of a commercial arbitration clause in a natural gas supply contract would be to achieve a "fair and reasonable" price. This standard is appropriate for regulated environments, but has no application to the competitive market. The Director further submitted that the conditions proposed by WGML to govern the private arbitration procedure would keep prices at artificial levels. The Director argued that private commercial arbitration is no solution to the public policy problems which are created by the introduction of measures which distort the workings of a competitive market.

Board Staff

10.7.44 Board Staff submitted that the Board ought not to mandate any particular arbitration clause, and ought not to mandate that an arbitration clause be included in gas supply contracts. Also, in its submission, the Board ought not to approve any arbitration clauses, or contracts containing such clauses, with a view to being bound by the price set by arbitration. According to Board Staff, the Board should retain its jurisdiction to review the price of natural gas being supplied to any customer in Ontario through an LDC, and not encumber its jurisdiction by accepting the results of an arbitration.

10.7.45 Board Staff submitted that if the Board did accept an arbitration clause, and proposed to be bound by the results, then it would abandon part of its obligation to fix just and reasonable rates.

10.8 Implementation

The LDCs

10.8.1 ICG submitted that there could be at least three areas which would require legislation, depending upon which policies were adopted. The first would be legislating mandatory standards for the ESCs, and determining which end users would be in that group. Second, if the LDCs were given the exclusive right to serve the ESCs, legislation would be needed. Third, if the Ontario government agreed that the Board should, after approving the arbitration clause, accept an arbitrated price for gas as part of an LDC's cost of service for rate making purposes, then legislation will probably be required to implement that policy.

10.8.2 Union submitted that it is within the Board's powers under the Act to provide for recovery through rates of the costs involved with the construction of new transportation facilities. However, if the Board imposed non-rate related conditions on access to contract carriage service by end users, legislation would be needed to clarify the Board's power to do so. Lastly, if the LDCs have an obligation to ensure that adequate supplies are available for any particular class of end user, subject to section 54 of the Public Utilities Act, then enabling legislation would be necessary.

10.8.3 Consumers' submitted that, in order to implement a policy which relies upon supplier certification for those serving the ESCs, amendments to the Act will be required. The amendments should give the Board jurisdiction to mandate the certification requirements, scrutinize supply contracts, certify the suppliers and enforce compliance.

The Brokers

10.8.4 ECNG submitted that the current public policy of the Province of Ontario should be affirmed rather than retrenched, and no legislative changes would be required.

10.8.5 GasPurchase and Ocelot were opposed to any legislative changes. They saw a role for government, however, in providing information on contracting guidelines for the direct purchase market. They cited the letter that the Saskatchewan Ministry of Energy and Mines sends out to all prospective direct purchasers as an example of what governments should do.

The Producer Associations

10.8.6 IPAC stated that mere guidelines, which are neither mandatory nor enforceable, are inadequate to protect the needs of Ontario customers. The Board should make a recommendation of policy to the LGIC and, if required, statutory amendments could be made.

10.8.7 CPA submitted that legislative amendments to the Act are needed with respect to mandatory contractual practices for the ESCs. In addition, amendments should be made if the ESCs are to be permitted to elect whether or not they will be served by the LDCs.

The Consumer Associations

10.8.8 IGUA submitted that the Board should recommend to the Government that gas purchasing guidelines should not be introduced at this time. If at some time in the future it becomes necessary for the supply arrangements of the ESCs to be examined and supervised, the Board can intervene under its rate making jurisdiction.

10.8.9 OAPPPA recommended that another review of the situation be conducted by the Board in two years time. OAPPPA submitted that the Board should recommend that a strong policy statement be made, criticizing the Alberta Government's definition of core market and its practices regarding removal permits.

WGML

10.8.10 WGML submitted that legislation or regulation should be developed to establish the ESC group, and to give the LDCs the exclusive right, and the resulting obligation, to supply the ESCs. In addition, contracting guidelines should be established for the ESCs. WGML recommended that governments and regulatory authorities take the necessary steps to establish an effective arbitration process.

The Director

10.8.11 The Director submitted that registration of marketers or individual transactions in the interest of customer protection may require legislative change.

Board Staff

10.8.12 Board Staff recommended that the LGIC be requested to legislate that the Board conduct a periodic review, by way of a public hearing, of the supply of natural gas and other related matters that might impact on security of supply in the province. Board Staff argued that legislation should be enacted so that the Board can mandate security of supply measures, impose a miminum contract term, and require all direct purchase customers to file gas purchase contracts in confidence. The Board should also be empowered to review the direct purchase contracts and prepare aggregate pricing information for distribution to interested end users in Ontario on a periodic basis.

10.8.13 Board Staff also asked the Board to recommend that any proposals which enhance the security of supply to Ontario be encouraged, assuming that they are otherwise meritorious. This would include the proposed Union interconnection to the State of Michigan and its contracting for short-term storage in that State.